2023 Europe

EMERGING TRENDS IN REAL ESTATE®

IN THE EYE OF THE STORM

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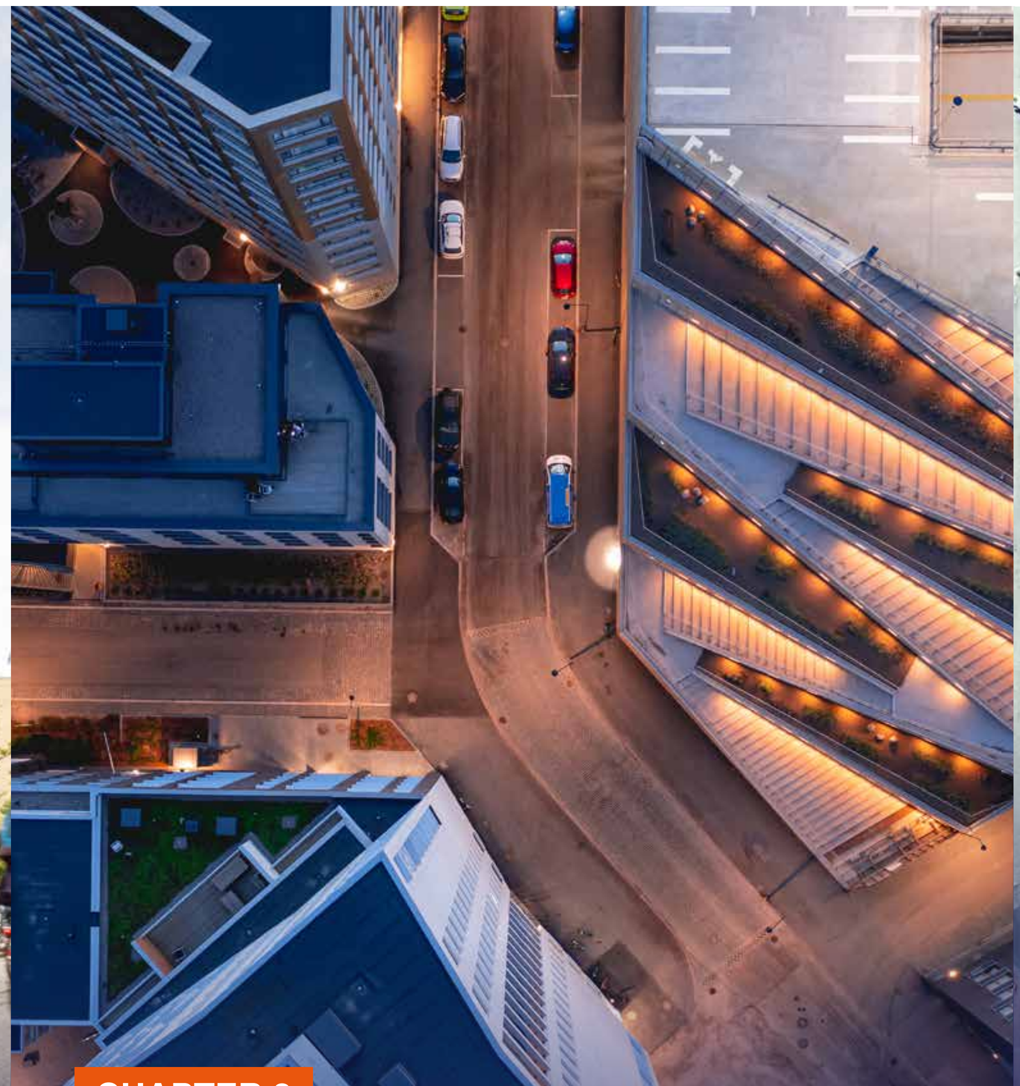
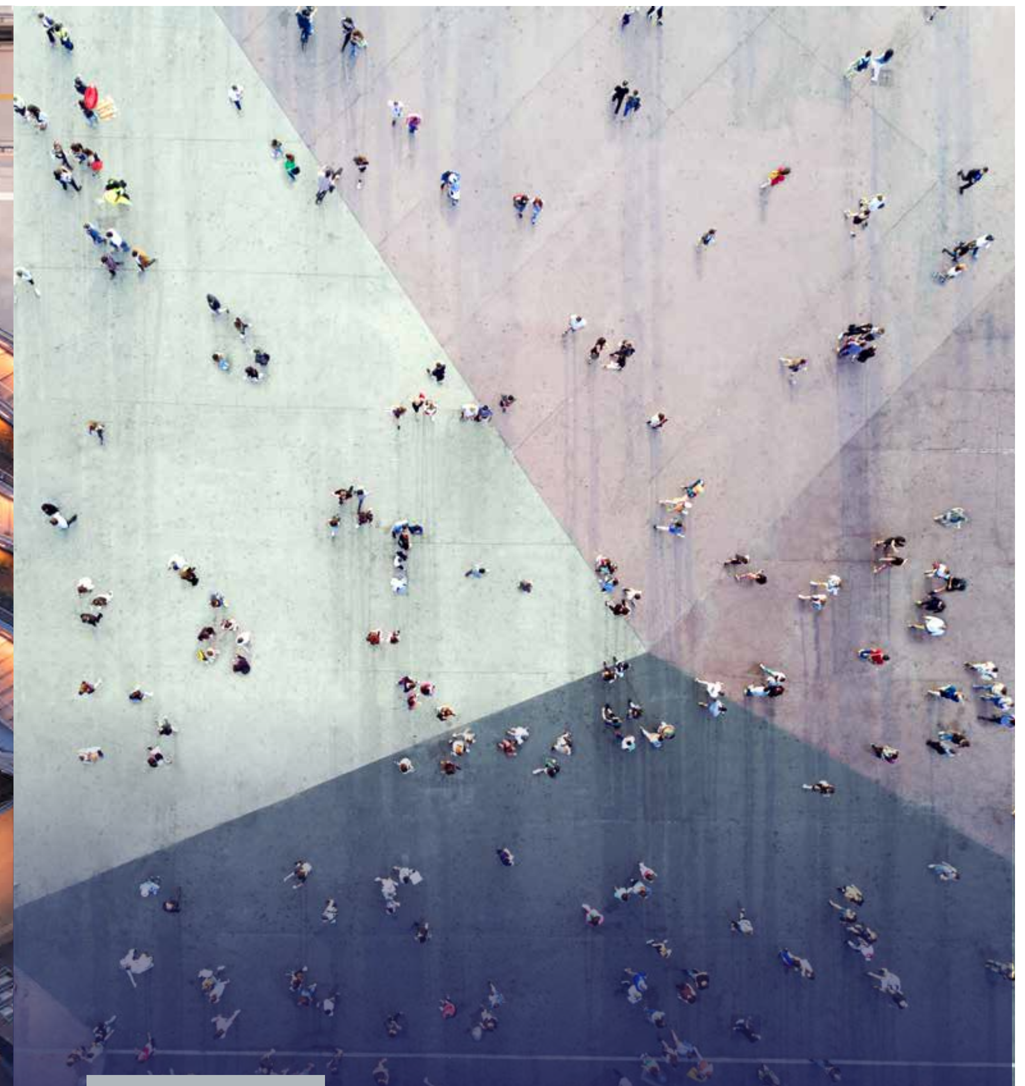
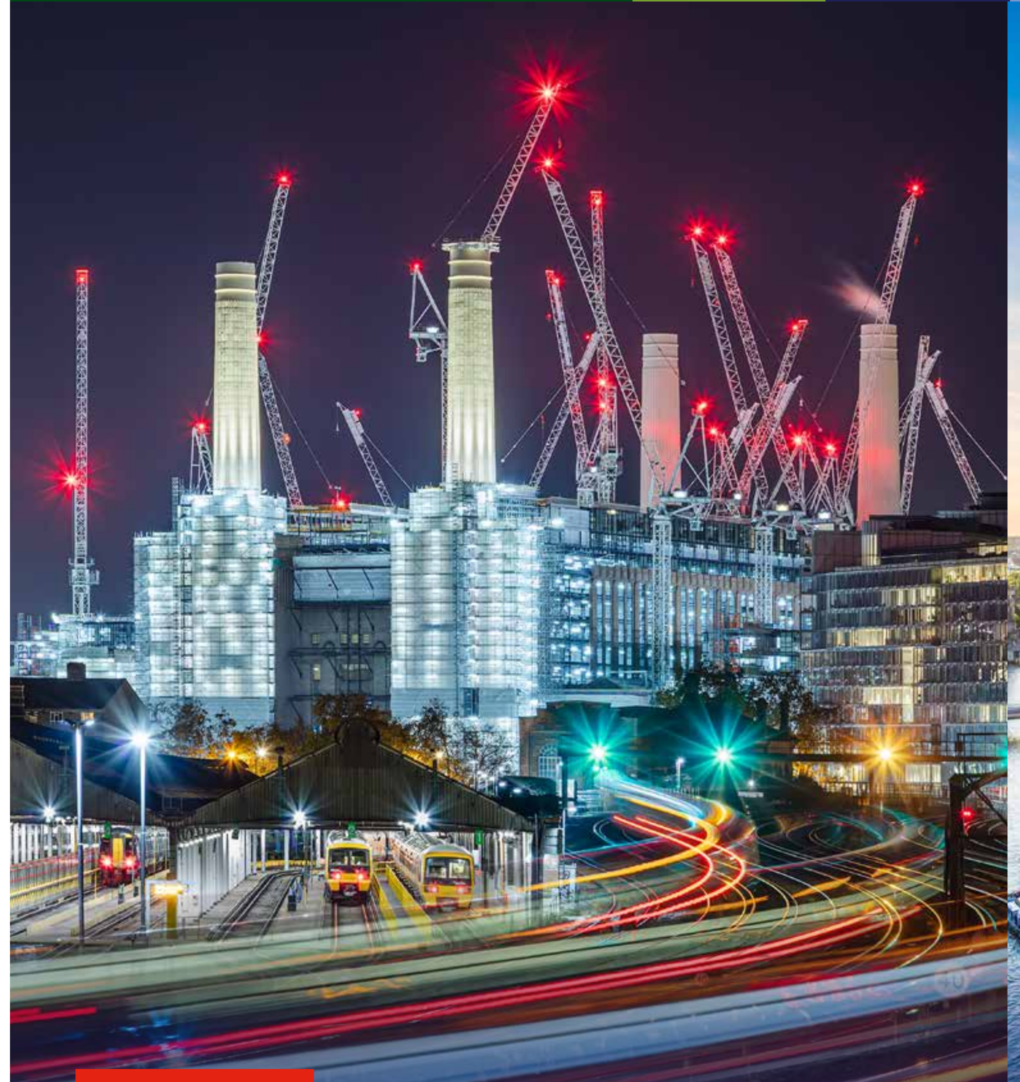




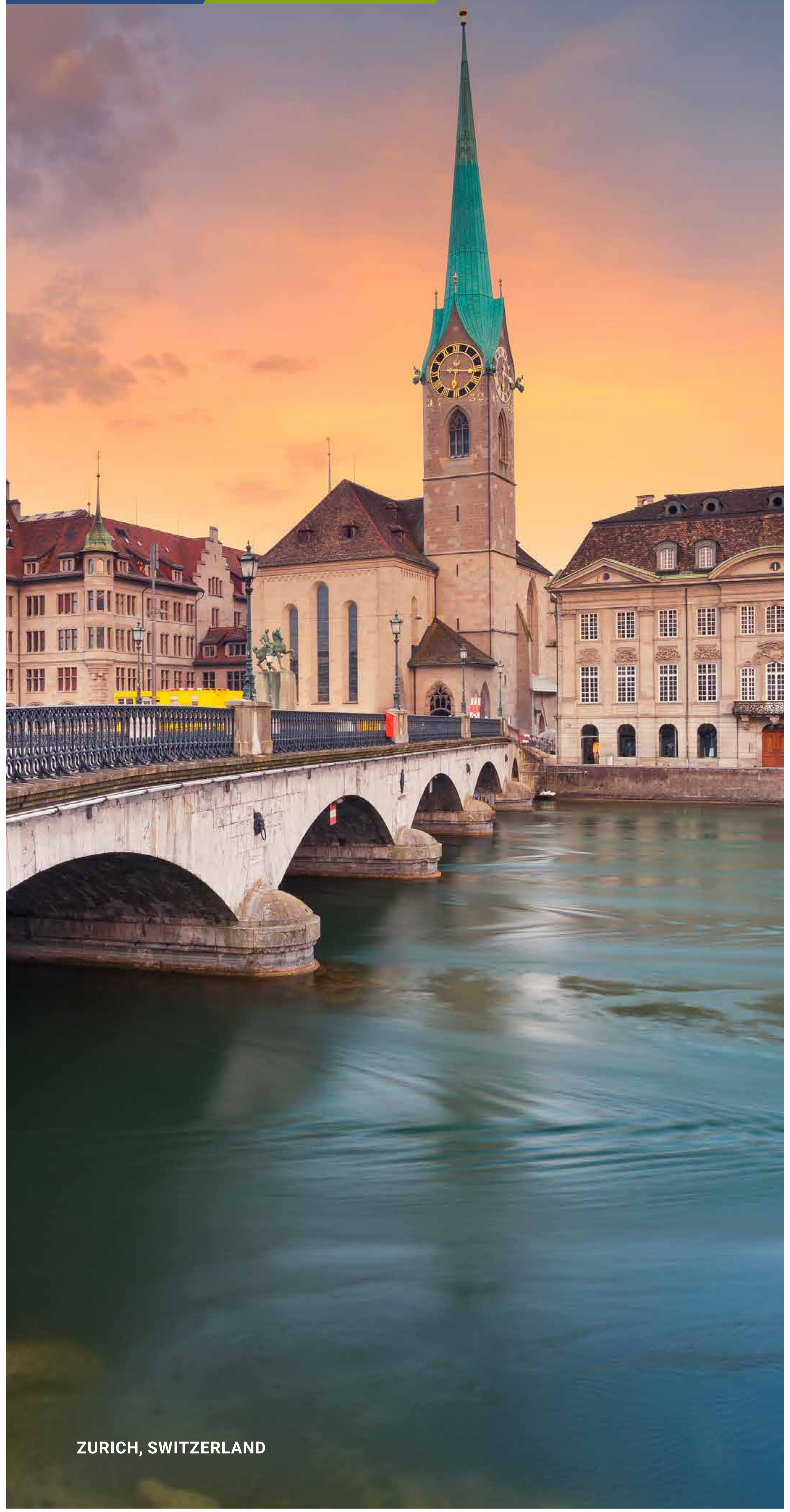


EXECUTIVE SUMMARY

"We are on the cusp of quite a significant slowdown, both in the real economy and in the underlying real estate markets."

Pan-European investment manager

MADRID, SPAIN



ZURICH, SWITZERLAND

The outbreak of war in Ukraine has cast a long shadow over Europe, and real estate, like every other industry, will have to deal with the economic and political fallout for the foreseeable future.

While the industry leaders canvassed for this 20th edition of *Emerging Trends in Real Estate® Europe* report little direct impact on their property portfolios from Russia's invasion of Ukraine, the war's consequences are seen in surging energy costs, historically high inflation and, latterly, rising interest rates. Seven out of 10 survey respondents believe Europe will move into recession before the end of 2022.

The survey and the interviews were conducted in the summer and, if anything, the prospects for the European economy and real estate markets have become even more uncertain in the months leading up to publication.

The mood is in stark contrast to last year's report when there was still a COVID-inspired solidarity among European countries as well as a coming-out-of-lockdown peak in business sentiment. Europe now appears far more unsettled by the pressures of energy supply and internal politics, which is adding to the overall uncertainty for investors.

Much depends on the severity and duration of the expected recession, and as interviewees point out, the economic circumstances and market conditions behind previous downturns are all quite different from what Europe is experiencing today.

Though the city rankings have a familiar look — London retains the top spot while Paris takes over second place from Berlin — the overall investment and development prospects for all 30 cities covered by *Emerging Trends Europe* have declined since last year's survey.

Even investors' other customary safe havens in Germany, Frankfurt, Munich and Hamburg, do not enjoy the same unwavering positive sentiment as previous years, reflecting the potential impact of inflation on Europe's largest economy and its dependency on Russian gas supplies.

Despite the prevailing uncertainty, leasing activity across Europe held up reasonably well for much of 2022. But there is a widespread belief that high energy prices and a recession will lead to occupancies and rents falling, even in previously robust sectors. It is clear that 2023 will be a tough year in any event, and as some industry leaders contend, a recovery may not emerge until early 2024.

Unsurprisingly, confidence in the availability of equity and debt over the coming year has sunk to its lowest level since the global financial crisis although it is unlikely that liquidity will disappear altogether. Development activity slowed in 2022 and is expected to fall sharply in 2023.

As a sign of the times, new energy infrastructure tops the sector rankings for the second successive year, partly reflecting historically high energy prices and the prospect of shortages over winter. This sector covers a wide range of real assets, such as solar, wind, energy storage and electric transport infrastructure. Its top ranking is also part of a wider, longer-term trend in which investors rebalance holdings away from mainstream real estate towards alternative sectors that will benefit from the megatrends of demographics, climate change and technology — and stronger, non-cyclical demand.

It is notable that various forms of housing dominate the top 10 picks from survey respondents — as they have done for several years — despite increased concerns over political risk in this sector. On a broad level, there is an acceptance that the balance between residential supply and demand in European markets has not changed in the past year, and it is unlikely to change any time soon.

The big fear is over the pressure on real estate values, which has been well signalled in the listed sector as discounts to net asset value continue to deepen. Direct property values started falling in 2022 and a further decline is now regarded as inevitable, with the pricing between prime and secondary real estate expected to widen.

Some of that concern has led to logistics, the one-time star performer, slipping down the overall rankings although it still stands at seventh place in terms of prospects for investment, and sixth for rental growth. But a sector that has seen yields compress to historic lows, sub-3 percent in many markets, is particularly exposed when values fall.

Many senior property professionals believe that inflation will peak at some point in 2023 and bring clarity over how much central banks are likely to raise interest rates. Assets might be worth less at that point, but there would be more direction over where values are likely to settle.

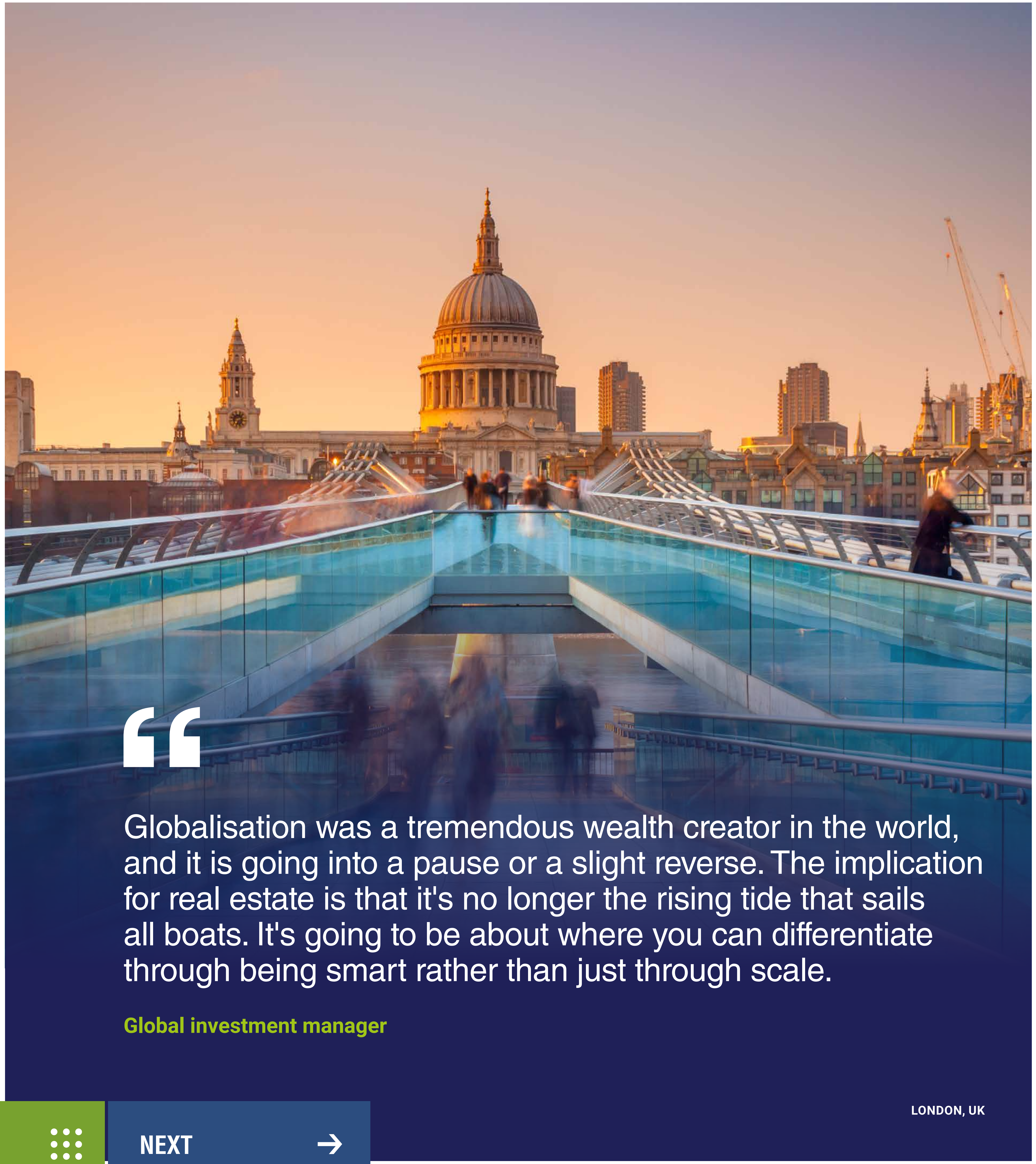
Yet in dealing with the immediate disruption to markets the industry appears to acknowledge that it must continue to evolve and respond responsibly to the long-term structural changes to real estate and the wider challenges around environmental, social and governance issues.

Nearly 90 percent of respondents highlight the importance of creating social impact alongside financial return over the next 20 years, while 60 percent identify the importance of increasing diversity in their organisations.

The challenge is always aligning actions with such laudable ambitions, and even more so in a year when issues around energy efficiency and supply have affected every European household and when economic constraints threaten to obstruct the path to net zero. Real estate's efforts here have a renewed criticality.

Nonetheless, as each year goes by, property professionals are thinking much more about how the industry conducts business and about the sort of real estate that will be "fit for purpose" for the long term. To mark 20 years of *Emerging Trends Europe* we have asked a broad range of industry players to explore such themes and how they may define real estate over the next 20 years while reflecting on the many market changes that have shaped the industry to date.

As set out in Chapter 7, the industry's move towards a form of "responsible capitalism" over the next 20 years is driven by many factors but above all by the climate crisis. It is one trend that has only gained in prominence and relevance throughout *Emerging Trends Europe's* history, connecting the past, present and future.



"Globalisation was a tremendous wealth creator in the world, and it is going into a pause or a slight reverse. The implication for real estate is that it's no longer the rising tide that sails all boats. It's going to be about where you can differentiate through being smart rather than just through scale.

Global investment manager

LONDON, UK

PREVIOUS CONTENTS NEXT

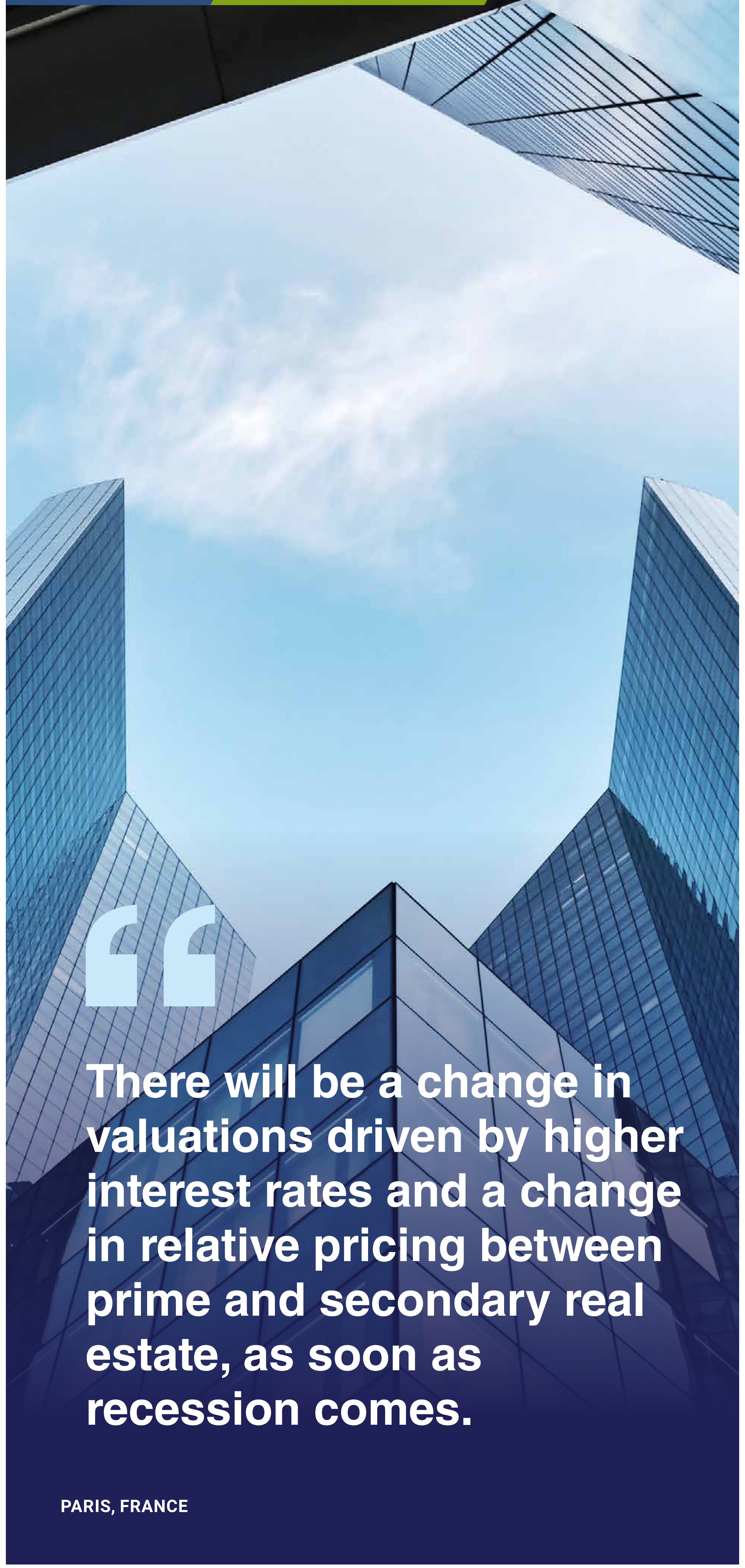
CHAPTER 1

BUSINESS ENVIRONMENT

“As investors, we are facing not only purely economic issues but also geopolitical ones that used to be interesting to understand but are actually now having a significant impact on our economies.”

Head of strategy, private equity firm

FRANKFURT, GERMANY



PARIS, FRANCE

If the third year of the pandemic was supposed to usher in signs of hope, the outbreak of war in Europe has delayed recovery and exposed significant structural weaknesses in the economic, social and political fabric.

Emerging Trends in Real Estate Europe 2023 finds the property world stalling at an uncomfortable crossroads, as rising interest rates hitched to soaring inflation drag Europe towards recession.

Summing up the mood across the industry, one Irish property leader says: "Europe is in for a very grim winter."

Following a brief, COVID-inspired, show of solidarity, Europe has become more unsettled by the pressures of energy supply and internal politics. States are even chiding each other for their economic short-sightedness over their reliance on Russian gas and have repeatedly failed to reach a consensus on the issue.

A global head of investment management notes that the differences are at times, stark: "If you're sitting in Germany or the UK, all of a sudden energy is a huge subject, whereas the French, benefiting from nuclear power, might be asking, where's the problem?"

But right-wing election successes in Sweden and Italy, a new Prime Minister of the UK and uncertainty in France all suggest that further upheaval is likely across the political landscape.

The European Commission will undoubtedly face a tougher ride in achieving unanimous decisions.

Says one German CEO: "Just look at sleepy and complacent Germany. I believe the heat we are feeling now is actually triggering some needed reforms that we couldn't have gotten a grip on without those external forces."

While those interviewed for *Emerging Trends Europe* report little direct impact on their property portfolios from the Ukraine conflict, the war's consequences are everywhere. "It's impossible to say we haven't been affected by the war. Just look at energy costs, inflation and interest rates," notes the CEO of a pan-European developer.

The resultant affordability crisis and recession risk — the effects of which are likely to impact all sectors in one way or another — have robbed the industry of the clear "safe-haven" sectors afforded by the first two years of COVID-19, such as residential and logistics. In the face of increasingly expensive debt, property professionals perceive that even the relative income security offered by operational assets is going to require greater effort and ingenuity. Many are waiting for clarity on pricing and yields.

"There will be a change in valuations driven by higher interest rates and a change in relative pricing between prime and secondary real estate," suggests the head of investment strategy of a pan-European investor.

The listed sector is already bearing the brunt as discounts to net asset value (NAV) continue to deepen, with a number of firms exploring the "take private" route. Italy's Coima is a recent example, delisting after just six years on the stock market. But the pressure is not limited to firms specialising in assets unduly affected by the current crisis – even the managing director of a profitable logistics group notes that "like everyone, our share price has dropped fairly significantly".

Investors do not like uncertainty. While many took an early summer break in the hope of resuming business as usual in September, the investment climate has continued to deteriorate significantly. Now, many transactions are on hold as fears have crystalised into clarity with borrowing costs higher than they have been in a generation.

Although real estate companies are not as leveraged as they were going into the global financial crisis largely due to the regulatory changes of the past decade and a half, double-digit inflation in some territories — and the spectre of stagflation — continue to weaken investor demand going into 2023.

"All market participants are acting very carefully, so liquidity is going down. I expect transaction volumes to fall off quite severely," says a global head of investment management.

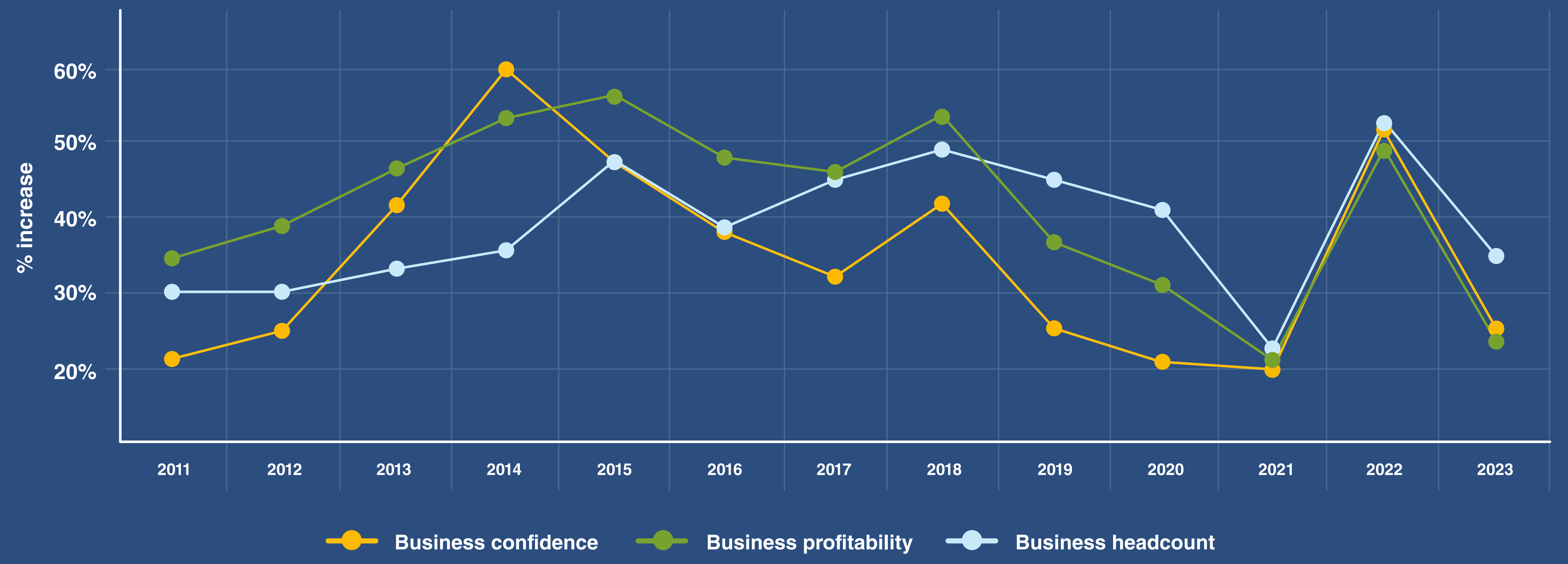
The focus on environmental, social and governance (ESG) issues is clearly still important to the industry, although the climate debate has in part been drowned-out by the siren call of macroeconomic woes, with construction costs inflated by congested supply chains. Yet as consumer and industry fears around affordability matters soar, real estate has an opportunity to dovetail social impact efforts and environmental stewardship – and tackle the materials and energy crisis – with a radical approach to sustainability. Previous editions of *Emerging Trends Europe* have found industry protagonists reframing real estate as "social infrastructure". Many in the industry believe the time to make good on that claim has arrived.

Says a global investment strategy chief: "New development has slowed down, refurbishment has slowed down, but despite this, the ESG commitments that we have all made for the next few years will have to be undertaken."

> All market participants are acting very carefully, so liquidity is going down. I expect transaction volumes to fall off quite severely.

Figure 1-1 **Real estate business sentiment, 2011-2023**

Source: *Emerging Trends Europe survey 2023*



Realism supersedes optimism

The survey signals a decline in profits and confidence in 2023, reflecting a cautionary mood across the industry. This is markedly different to last year, when there was a coming-out-of-lockdown peak in sentiment.

"The availability of both equity and debt capital has declined. Investors have become more selective and banks have become more risk averse," notes a global head of real estate investment.

However, while the proportion expecting business confidence, profitability and headcount to increase has fallen compared with 2022, the overall share is still higher than in year one of the pandemic. Headcount remains the most positive indicator with 56 percent of respondents expecting numbers to remain the same.

The results suggest that the currently tight labour markets are on the whole driving a staff retention policy with only 10 percent of respondents envisaging letting people go.

"We have a lack of labour forces, and we have pressure on salaries and wages, which never happened in the middle of a recession before," says a pan-European real estate CEO.

Even so, European real estate faces a major challenge from a quartet of inter-linked economic headwinds, and there is a noticeable increase in concern from industry leaders compared with 2022.

Worries over inflation, interest rates, European and global economic growth are all sharply up on last year — and even then, they were starting to alarm a majority of respondents. But this time, there is almost complete consensus that inflation is "concerning" — according to 91 percent of industry leaders. This contrasts markedly with 2022 when the greatest concern was cybersecurity, according to just two-thirds of respondents.

"It's very difficult to stay competitive in this inflationary environment," concludes a roundtable of ULI members in Belgium and Luxembourg.

Only a few perceive an upside to the inflation issue. "If money becomes worth less, existing money will be invested more in real estate. High earners are still buying property as an inflation hedge," according to a panel of Austrian property professionals.

Unsurprisingly, interest rates follow closely behind as a chief concern on 89 percent, while sluggish European growth is another red flag for 88 percent of respondents. Downturn risks in the global economy are significant for 81 percent of respondents – twice as many as last year.

> "If money becomes worth less, existing money will be invested more in real estate. High earners are still buying property as an inflation hedge.

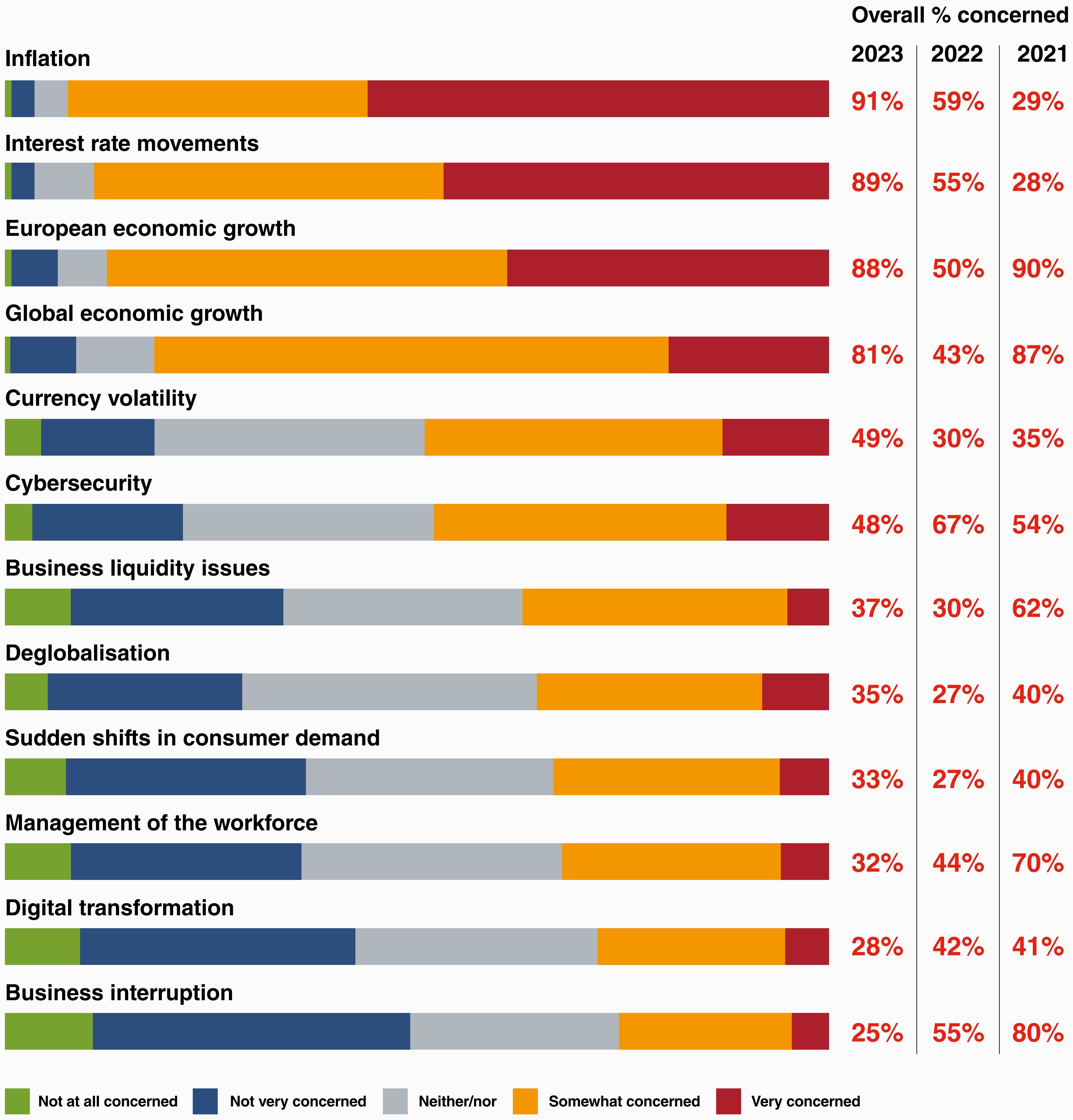
"Europe has little gas and oil, which is making energy expensive. The risk is that locations across the continent will lose their attractiveness for industrial and commercial production, and international companies will be the first to leave," warns a global head of real estate.

"We really must get a grip. We can't rely on China for our economy, on the US for our national security, and on Russia for our energy," states the CEO of a pan-European developer.

In August, US president Joe Biden signed the Inflation Reduction Act into law, a policy designed to reduce the country's deficit while potentially easing consumer spending on healthcare. Notably, it has also been called the largest climate investment in US history, with several provisos to increase energy security. It will largely be paid for by corporations.

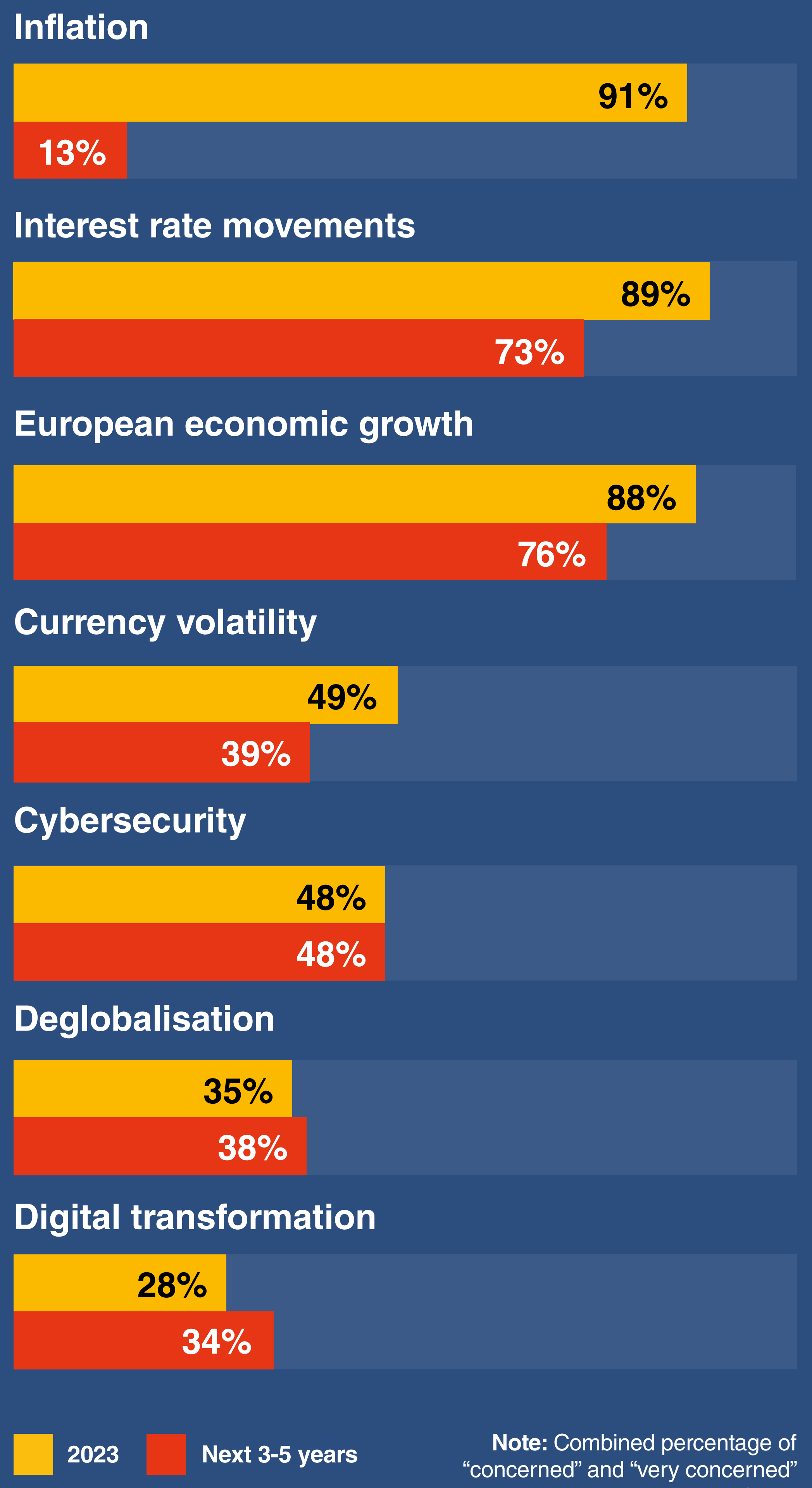
The EU and UK response has included the central banks of both raising interest rates.

Figure 1-2 **The European business environment issues causing concern in 2023**



Source: *Emerging Trends Europe survey 2023*

Figure 1-3
European business environment concerns for 2023 and over the next five years



Note: Combined percentage of "concerned" and "very concerned" respondents.

Source: *Emerging Trends Europe survey 2023*

As it announced a record rise of 75 bps in September, the European Central Bank stated that "a gradual but sustained path of further increases in interest rates will be appropriate".

While the inflationary risk is highlighted by survey respondents and interviewees, they also express grave concerns about the impact on business of rising interest rates.

"The fact that interest rates shot up and became volatile and unpredictable hasn't helped the investment market," says one real estate fund manager.

Nearly three quarters of survey respondents believe Europe will move into recession before 2023, further cementing the hit to development activity provoked by the last two years of supply chain woes, increasingly high borrowing costs and a general lack of financing. Germany and the UK look unlikely to escape this fate, while countries such as France and Spain are more insulated than their neighbours, largely due to how they source energy.

Several respondents flag the centrality of energy security as a predictor of recession or at the very least, an economic slowdown.

One German managing director voices the widespread fear over Germany's fate should Russia turn off gas pipelines permanently. "If Putin really cuts off the gas supply, I would assume that we [in Germany] are ending up in lockdowns again. Or, let's say, closures of certain parts of business, which are probably not system relevant."

Due to the fractured nature of the energy security issue, however, views on recession risk vary across Europe. According to the survey, recession is very likely before 2023 for 83 percent of respondents in Germany, 82 percent in the UK, 79 percent in the Netherlands, and 68 percent in Spain. In contrast, Italian (50 percent) and French (45 percent) respondents are more sanguine.

"The key is going to be how long are we going to live with high inflation and high rates, because these translate into a recession and can further translate into stagflation," says the CEO of a Spanish real estate firm.

A Netherlands-based managing director adds: "I don't think there will be a deep recession, but there may well be two or three quarters of slowdown."

Over the next five years, the industry indicates a similar level of concern over many of the key business issues, with European economic growth (76 percent) and interest rates (73 percent) in pole position, followed by global economic growth.

"I would think there's definitely going to be a slightly more challenging business environment for the next three to five years," notes a senior management figure at a private equity firm.

> The fact that interest rates shot up and became volatile and unpredictable hasn't helped the investment market.

The exception here is inflation: as interest rates rise, just 13 percent of respondents are concerned about its medium-term impact.

A UK-based global real estate head explains: "We forecast that inflation rates will remain elevated until Q1 of next year, and then taper off to around 2 percent, 2.5 percent over the remaining window. Interest rates should be similar."

A Europe-based head of investment strategy for a global real estate fund is also optimistic: "I think inflation is going to peak relatively soon. It will probably peak at some point in the next three to six months. Oil prices have already gone down and the market is expecting interest rates to peak probably by the end of 2022, maybe 2023, and then go down, triggered by a recession."

Building a sustainable future

Despite the macroeconomic uncertainty, environment and sustainability strategies remain key priorities for most industry leaders in 2023. For many of them, climate risk represents the biggest challenge facing real estate.

"There is no single discussion you will have with any peer in real estate that does not end up referencing ESG and decarbonisation," says a European head of asset management.

The environment will be a significant issue for more than half of property professionals in the coming year. The surprise is that 45 percent of respondents do not regard this as a concern today, although this could tie in to their longer-term observations. Indeed, 64 percent of respondents see sustainability requirements and regulations as a key concern over the next 3 to 5 years.

Those who are less concerned suggest they have more urgent priorities. "The short- and medium-term concerns are the market's inflationary tendencies. In the long term, the issue is the environment," says a real estate investment manager.

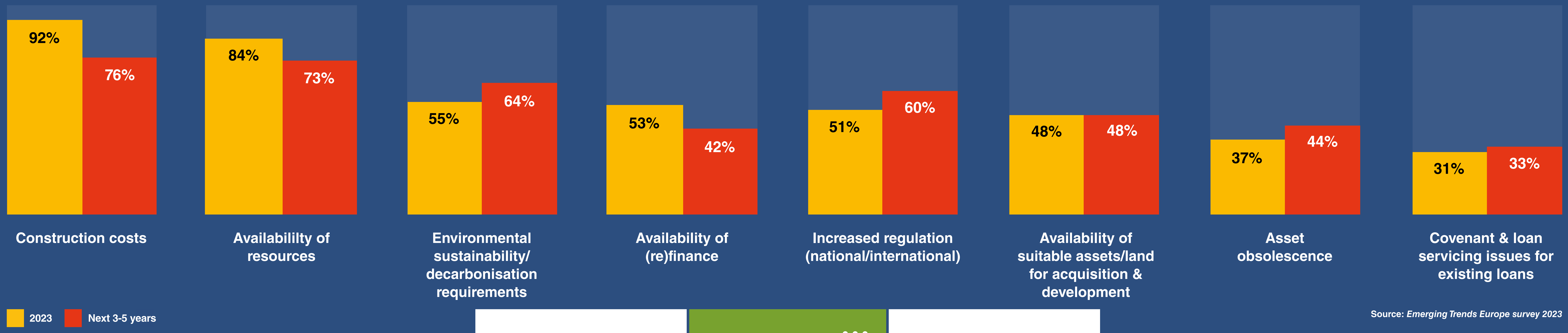
The likelihood of greater regulation shaping ESG has been a recurring theme in *Emerging Trends Europe* over several years, but this time the survey suggests a step-change in its importance to the industry. Half of the respondents regard it as an issue for the coming year and even more so, 60 percent, for the medium term.

For one pan-European CEO, this emerging trend is long overdue. "We created a lot of new rules such as those governing taxonomy in the last few years, which many saw as another layer of bureaucracy, rather than a new way of considering our overall contribution and the necessary, and deep transformation towards a much more sober way of doing business."

> There is no single discussion you will have with any peer in real estate that does not end up referencing ESG and decarbonisation.

Figure 1-4 **Real estate business issues in 2023 and over the next five years**

Note: Combined percentage of "concerned" and "very concerned" respondents.



Source: *Emerging Trends Europe survey 2023*

PREVIOUS
CONTENTS
NEXT

However, respondents' top two real estate issues for 2023 are construction costs (92 percent) and availability of resources (84 percent) in the light of materials and labour shortages and related inflationary pressures. While construction costs have been at or near the top of industry concerns for years, supply-chain issues that started during the pandemic have been exacerbated by war in Ukraine, with fuel, copper and aluminium particularly affected. Russia and Ukraine are also key exporters of speciality metals, and the conflict has caused significant disruption of labour in the construction trade.

"Higher construction costs are down to two things. High commodity and fuel prices, but also supply chain disruptions," suggests one real estate strategy head, before noting that the latter "are starting to ease."

Yet the survey indicates that significant improvements on the construction front are unlikely in the coming three to five years.

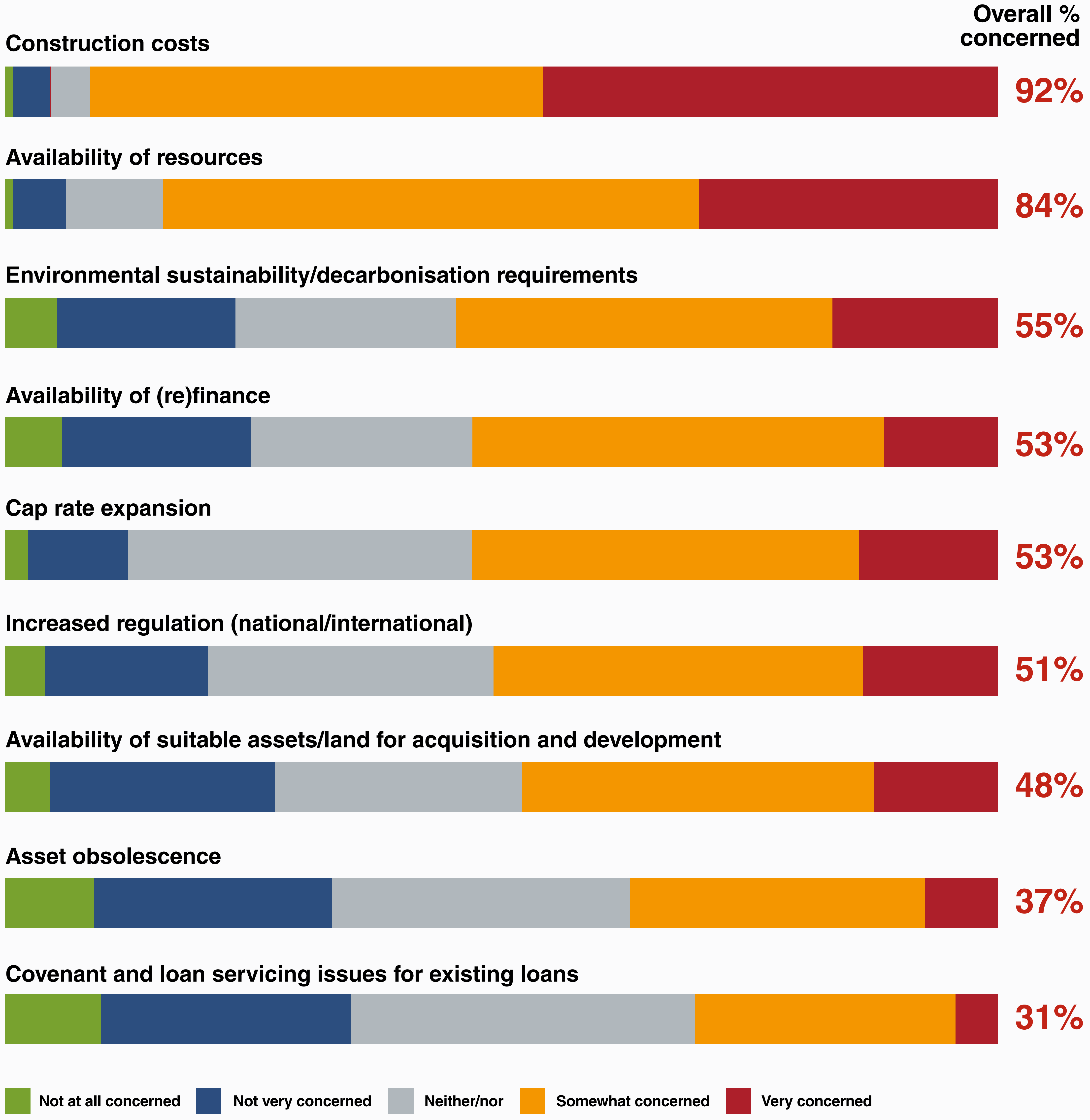
Around three quarters of respondents believe that construction costs and availability of resources will remain top of the list of concerns over that period.

"The whole issue of construction is actually very hot at the moment, and anyone who has to build now is expecting a cost escalation that would have been unimaginable 12 months ago," says one pan-European asset manager.

Disrupted supply chains have led to "an explosion in construction prices," according to a European head of real estate investment. "Binding construction cost commitments, from one's own contractor as well as from others, are no longer available. This makes planning difficult."

"The whole issue of construction is actually very hot at the moment, and anyone who has to build now is expecting a cost escalation that would have been unimaginable 12 months ago.

Figure 1-5 **Real estate business issues causing concern in 2023**



Source: *Emerging Trends Europe survey 2023*

The impact of war

As might be expected, Russia's invasion of Ukraine is the top social-political issue for nearly 90 percent of industry leaders, but largely for indirect reasons. The inflationary environment and all its consequences are the prime issue, with few respondents describing the impact of war in strictly territorial terms.

"We haven't seen direct effects — but energy costs have just exploded. That coincided with high inflation, which was around before, has led to interest rate reactions by the respective institutions that affect everyone who works in real estate," says a pan-European real estate CEO.

The second highest social-political concern is international political instability (79 percent) while European and national political instability also feature. Though the war in Ukraine is uppermost in the minds of many, the arrival of new political leaders in the UK, Sweden and Italy is also informing sentiment. The populism factor has not gone away in Europe, Brexit seems far from being resolved, and inter-European relations are likely to be on an evolutionary course in 2023.

"Italy is like a time bomb for Europe, while the UK, also because of the Brexit issue, has been at a standstill for six months," says the senior managing director of a global real estate firm.

Financial markets are wary as to whether Italy's new far-right coalition government could spark another European sovereign debt crisis following promises of increased public spending. Likewise in the UK, "trickle-down" economic policies have attracted criticism for extending government borrowing while the country braces for recession.

Given the overall downbeat mood, only around half of this year's survey respondents expect to be net buyers of European real estate next year. This figure is down on last year (59 percent) and slightly more bearish than survey respondents were during the pandemic – 55 percent were net buyers in the 2021 report. If anything, however, sentiment has dipped further since the survey was conducted in the summer.

"We've already seen some of the more highly levered investors effectively cut out of the market completely," indicates a pan-European developer.

Despite the overall uncertainty about the near future, the interviews and roundtables reflect differing views across sectors, specialisms and geographies.

Though last year's "safe haven" sectors, such as logistics, are certainly challenged by the macroeconomic environment, pure logistics specialists remain more buoyant than some of their counterparts in other sectors.

"Occupancy is the highest it has ever been, rent growth is the highest it has ever been. Customer demand is still really, really strong," says one pan-European logistics developer and investor.

In general, the potential weakness in occupier demand in most other sectors is influencing a broad shift to a more cautious approach to risk, even for those already in the core space. As covered in more detail in Chapter 3, the jury is still out on how distress will emerge from the prevailing market conditions. On the whole, interviewees do not foresee an influx of poorly performing assets onto the market, but the deep discounts to net asset value in the listed sector during 2022 are ringing alarm bells for property values in the coming year. With open-ended funds there are concerns over the distress risk and a possible run on redemptions. Institutional investors are also assessing the so-called "denominator effect" of falling values in other asset classes on their real estate allocations.

"We will probably see distress to the extent that certain funds suddenly become over-allocated to real estate and therefore need to sell. Now, they won't sell at any price, but they'll probably sell at less than what we would call market prices because there's some kind of urgency," says a pan-European real estate chief.

51%

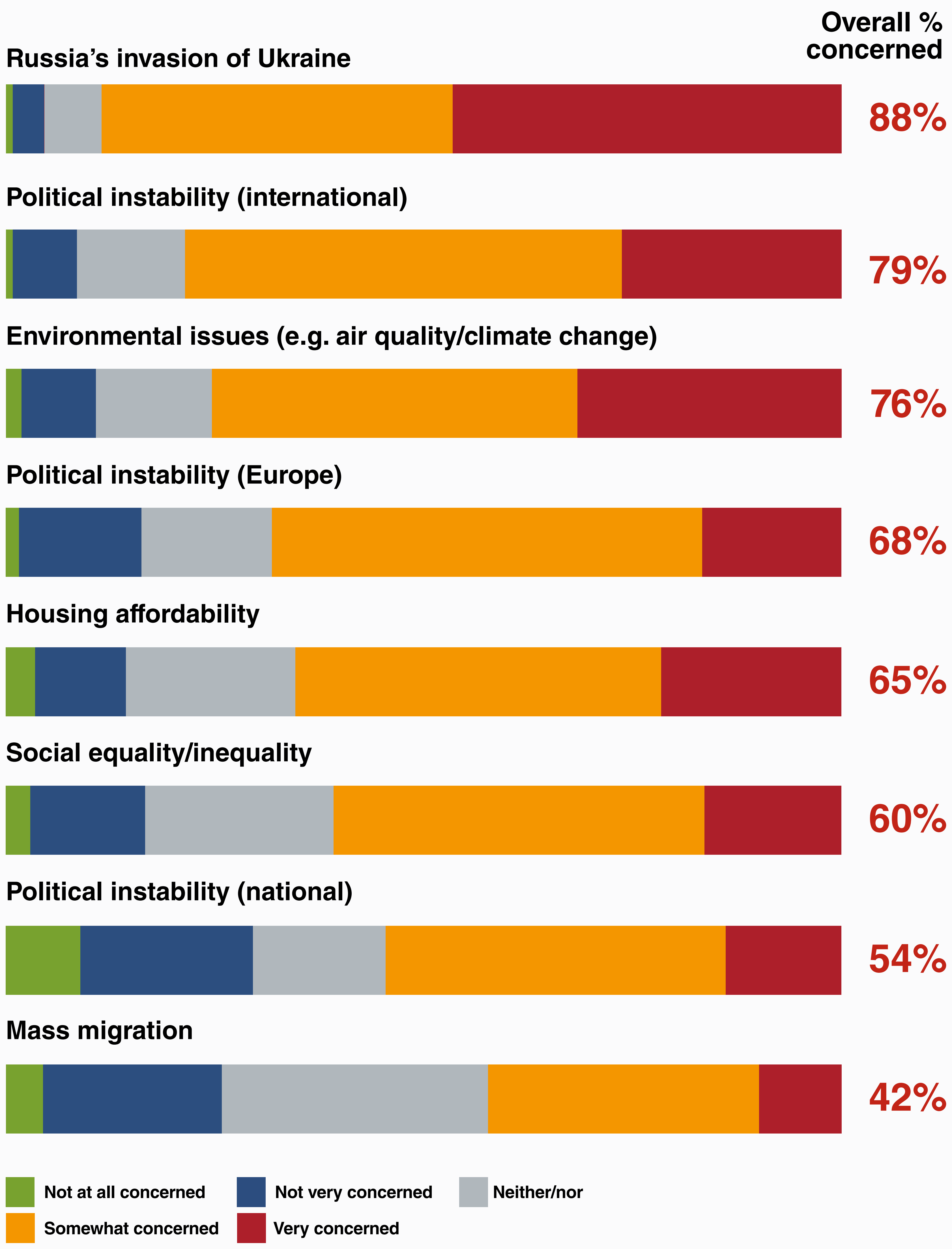
of respondents are aiming to be a net buyer of real estate assets in Europe.

Figure 1-6
Appetite for European real estate in 2023

Source: *Emerging Trends Europe survey 2023*

THE MOTHERLAND MONUMENT IN KYIV, UKRAINE

Figure 1-7 **Social and political issues causing concern in 2023**



Source: *Emerging Trends Europe survey 2023*

There is a flip side to distress in a downturn, according to the CFO of a Nordic real estate company: "It is in troubled times that the best deals are made, and I believe that the coming time will open up opportunities for those who have access to capital."

Adds a pan-European CEO: "Bearing in mind that economic uncertainty is not good for real estate, we believe that once healthy levels of inflation and interest rates are restored, confidence and investment in real estate will return."

> Bearing in mind that economic uncertainty is not good for real estate, we believe that once healthy levels of inflation and interest rates are restored, confidence and investment in real estate will return.

CHAPTER 2

ENVIRONMENTAL & SOCIAL IMPACT

"People are working much harder to measure social impact — to do the right thing and be held accountable. But as an idea, it's still plagued by a lack of standardisation, and the industry needs to work harder still to speak with one voice about what it's doing."

UK fund manager

CYCLISTS RIDING IN AMSTERDAM, NETHERLANDS

For an overwhelming 93 percent of the industry leaders surveyed for *Emerging Trends Europe*, running an environmentally and socially sustainable business is the most important factor for successful organisational transformation in real estate over the next 20 years.

"Those who didn't pay attention to the three letters of ESG until now hadn't realised that we are already in a time of transformation. As always, the current crisis is accelerating existing trends," notes one pan-European CEO.

Nearly 90 percent of respondents highlight the importance of creating social impact alongside financial return over the next 20 years, while 60 percent identify the importance of increasing diversity in their organisations.

"We now have a number of internal committees tackling these matters, and our policies include very progressive diversity and inclusion guidance," reports the director of environmental, social and governance (ESG) at a global institutional investor.

The challenge is always aligning actions with such laudable ambitions, and even more so in a year when questions around energy efficiency and supply have affected every European household, and net zero has become political warfare. Real estate's efforts have a renewed criticality.

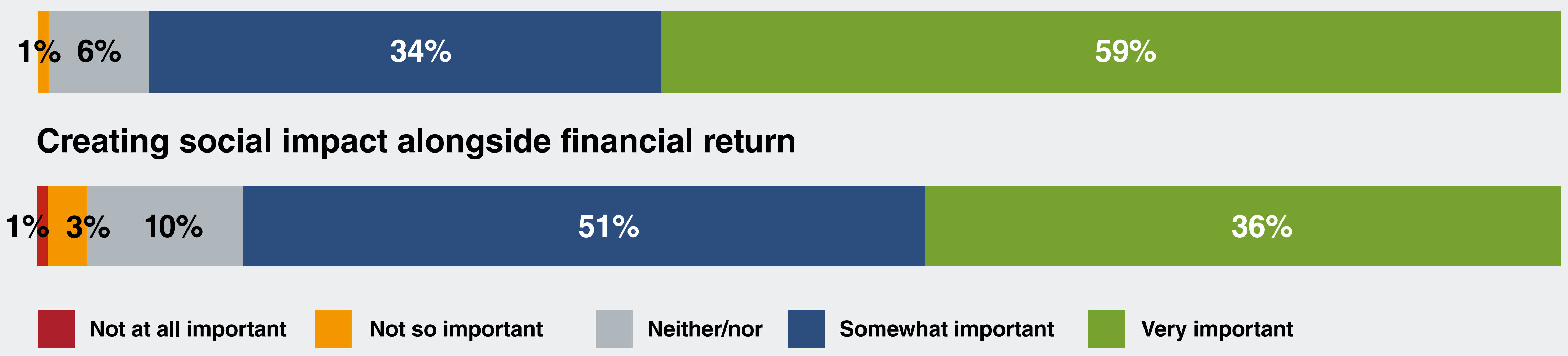
"We have to achieve an energy turnaround, where buildings generate the energy they consume themselves and can also feed energy into the grid. Heat recovery, district heating, even the building materials should become more sustainable," suggests a global head of real estate.

Others see the economic climate as a hindrance more than a help in tackling ESG-alignment. "The cost factors surrounding refurbishments and new buildings at the moment could act as a break in the market because of the uncertainty in terms of what the end value is and what the cost of building really is," says a global institutional investor.

Yet the operational performance of buildings is no longer just a part of the E in ESG. It has big implications for the S, too — the social impact as tenants face significant affordability pressures due to high rents and now increasing energy costs. This comes back to the concept of real estate as "social infrastructure" and if not addressed can affect financial returns.

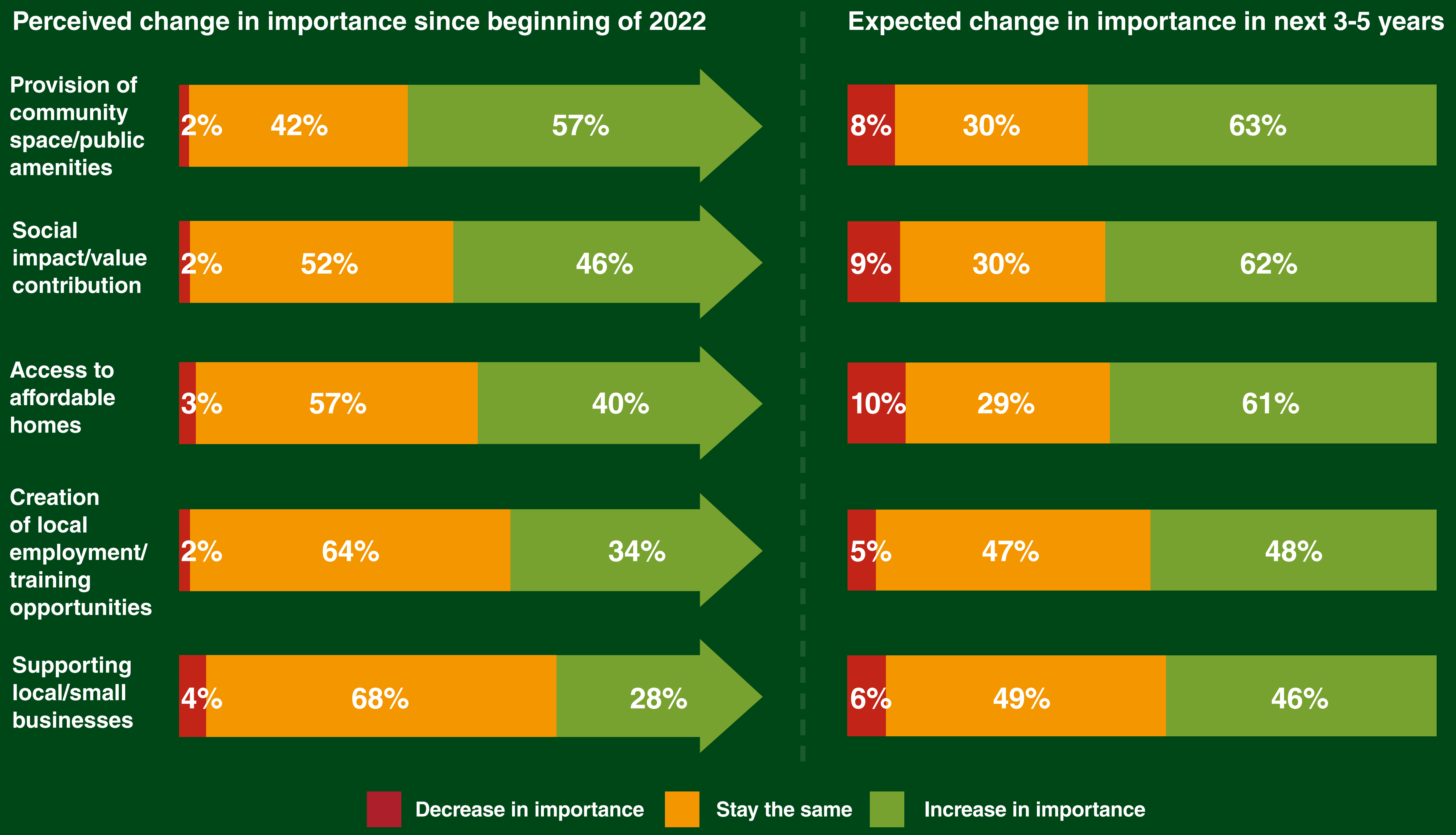
The S factor has gained visibility in recent years, with industry leaders seeing it as a means of improving their organisations and serving the wider community. Progress is slow, however, according to the survey. When asked about the social aspects in portfolios, the provision of community spaces has been the industry's top priority during 2022 albeit increasing in importance for just 57 percent of respondents. Responses are slightly more encouraging over the next five years.

Figure 2-1 **The importance of ESG for the successful organisational transformation of the real estate industry over the next 20 years**



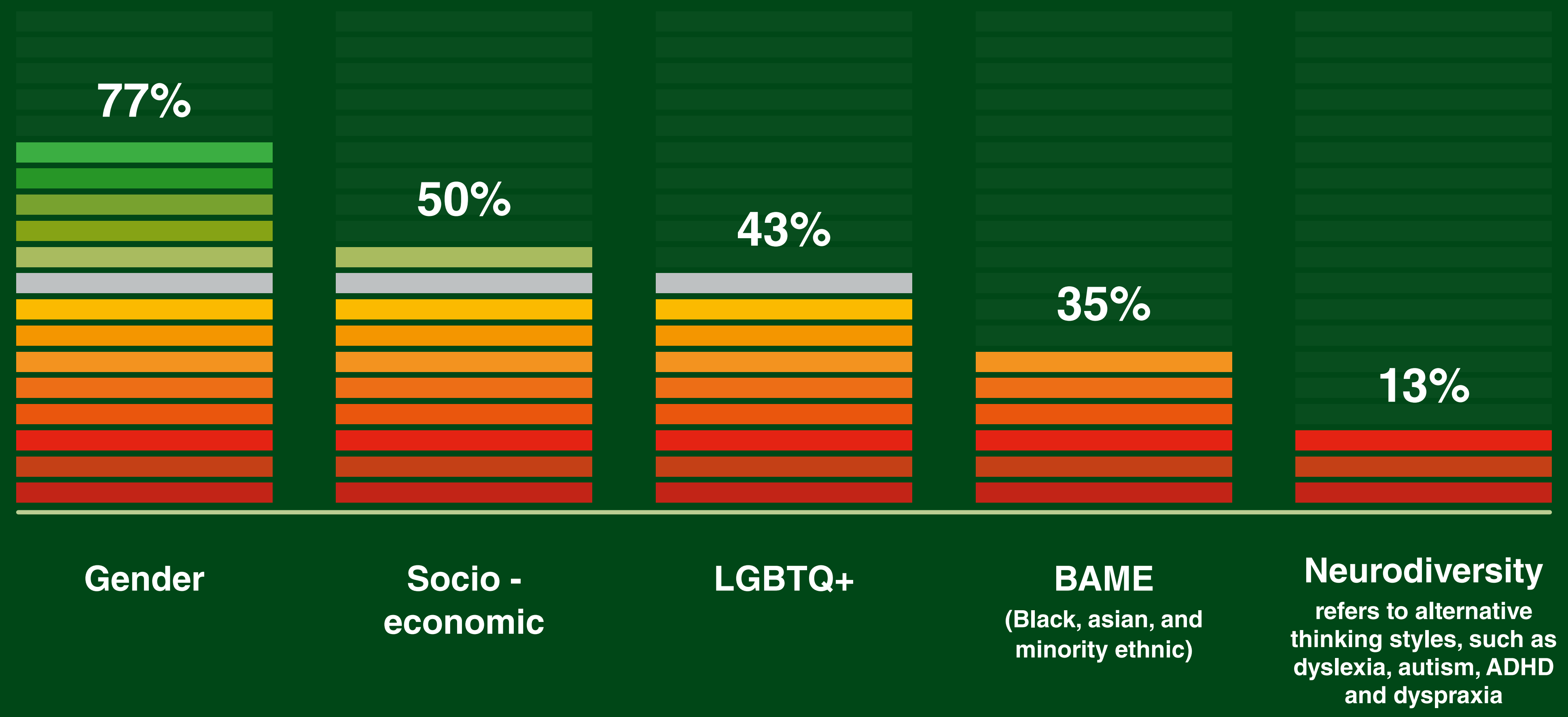
Source: *Emerging Trends Europe survey 2023*

Figure 2-2 **The changing importance of social issues within a portfolio**



Source: *Emerging Trends Europe survey 2023*

Figure 2-3 **The diversity, equity and inclusion categories that companies are actively addressing**



Source: *Emerging Trends Europe survey 2023*

LGBT PRIDE PARADE IN ISTANBUL, TURKEY

"In the future, property owners will need to show responsibility towards the community, as new zoning plans will be much more strictly regulated over the next ten years," says one Swedish property player, adding however that "financial incentives will be required to get the private sector on board".

Indeed, the industry has already started to recalibrate how it looks at social impact. Early attempts to make real estate "humancentric" were often simply about tenant retention; today, they have evolved into wide-ranging programmes to deliver projects whose overall value is linked to their social worth. These include conspicuous health and wellbeing solutions for a post-pandemic world, as well as diversity targets and local employment drives.

If offices are now for collaboration, since solo work can be done by many at home, spaces need to promote interaction and creativity. Retail-led schemes and mixed-use developments must increasingly foster community engagement to achieve commercial success. Perhaps the best opportunity lies in broadening the use of residential amenities, so they serve the individual and the wider community, across both private and subsidised housing.

Not all industry leaders are wholly convinced about the cost benefits of providing socially-inspired amenities. As one Austrian interviewee concludes: "It pays off for larger projects, but not for smaller projects."

However, the growing awareness of the real estate's broader role and obligations in society underpins more and more decision-making across the industry. If cities are ecosystems, then buildings and their users are in a state of symbiosis. And like any habitat, small changes can have a big effect.

Recent headwinds such as the tight labour market and the resulting war for talent, housing supply pressures and Europe's energy security crisis have huge implications for both society and real estate. The industry, more than ever in "hands-on", operational mode, evidently has further problems to solve.

For some, this is where the diversity, equality and inclusion (DEI) issue also plays in. This matter has emerged simultaneously on more than one continent in recent years, fired by simmering racial tensions and questions around poverty, opportunity and social justice.

When it comes to promoting DEI in their organisations, 50 percent of real estate leaders say they are actively addressing socio-economic policies this year compared with 37 percent last year.

But in the face of worsening economic conditions, the industry again seems poised between riding out the storm or trying to harness it to sail forward with greater speed.

According to one global investment manager: "The real estate industry needs highly skilled people with even more 'dimensions' than 10 years ago. And I find this particularly interesting because it shows that you cannot automatise our industry. We call it an industry, but it is everything but an industry, it is all handmade."

Whatever the medium and long-term outlook for social matters in real estate, some would say that the current macroeconomic conditions — chiefly high inflation, high energy costs and rising interest rates — strengthen the case for urgent action because they disproportionately affect poorer members of society.

Yet there remains a sense across the industry that the required legislative lever for social impact is confined to development and largely missing in all other aspects of real estate activity. "There are no established criteria for social impact investment right now. Except one, which is affordable housing," notes a global head of investment management.

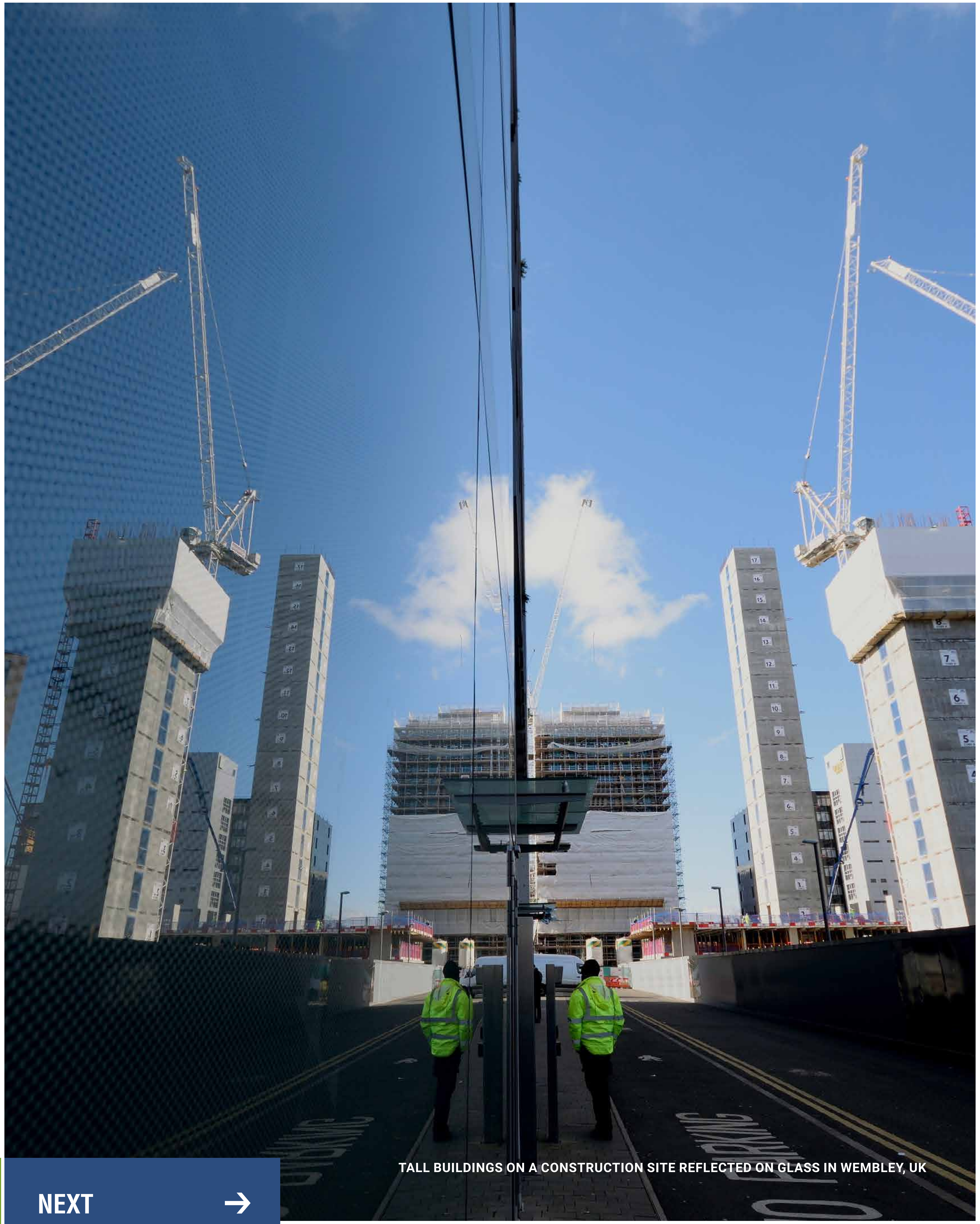
And where the state does intervene, there is no guarantee of success. For example, Danish property professionals note that the City of Copenhagen requires that as much as 40 percent of all new homes are affordable — recently raised from 25 percent — which could drive developers away from the sector altogether.

When it comes to self-directed action to tackle social equity, progress remains ad hoc. Several interviewees are proud of initiatives to train and hire local labour, but housing affordability overall is well down the list of criteria for survey respondents when selecting a city for investment.

While residential features ever more significantly on the allocations of investors interested in playing a social role, one real estate lender flags the hypocrisy risk: "If you have a business plan where you set rent increases of 10 to 20 percent, that makes total sense from an economic point of view, but can that still be called 'social'?"

Real estate's priorities have always been in a constant state of evolution although it seems like the dated caricature of grasping landlords unconcerned for their tenants' welfare can be substantially archived. Yet how the property world fully and satisfactorily aligns future profits with a wider social objective is still in flux.

> The real estate industry needs highly skilled people with even more dimensions than 10 years ago.



TALL BUILDINGS ON A CONSTRUCTION SITE REFLECTED ON GLASS IN WEMBLEY, UK

CHAPTER 3

REAL ESTATE CAPITAL MARKETS

"Our investors are really cautious, and not just for real estate. It's not the time when they want to build up more exposure to virtually any asset class. I don't say we see a lot of capital pulling out of the market, but it's difficult to grow at the moment."

Pan-European investment manager

HELSINKI. FINLAND

After a decade of plentiful liquidity in European real estate capital markets, when asset prices rose in most sectors in most countries, the story has changed dramatically as the industry looks to 2023 and beyond.

Inflation is up, interest rates have risen and have further to go, industry leaders believe, and recession is a spectre that haunts European economies. Equity and debt, in turn, are harder to come by, and interviewees report that valuations have fallen significantly in major markets, albeit empirical evidence is limited so far.

Though liquidity may not disappear altogether as it did during the global financial crisis (GFC), confidence in the availability of capital has sunk to its lowest level since those dark days. And a confluence of economic factors means the industry is facing a reckoning that many thought would arrive in the wake of COVID-19. Instead, it has come 18 months later.

As one large private equity investor says: “You’ve got dead markets that are meaningfully much less liquid than they were.”

Another global player adds: “It doesn’t feel like the GFC. It’s not necessarily an enormous liquidity crisis. There’s a lot of good news still coming through, and people aren’t levered in the same way that they were. However, the relative value of other asset classes means there’s no doubt there’s going to be a repricing. It’s happening already.”

Europe facing recession

Seven out of 10 survey respondents believe Europe will move into recession — before 2023 — and views about the prospects for the economy and the real estate sector have become rapidly more negative as a summer of uncertainty turned into an autumn of consistently downbeat forecasts.

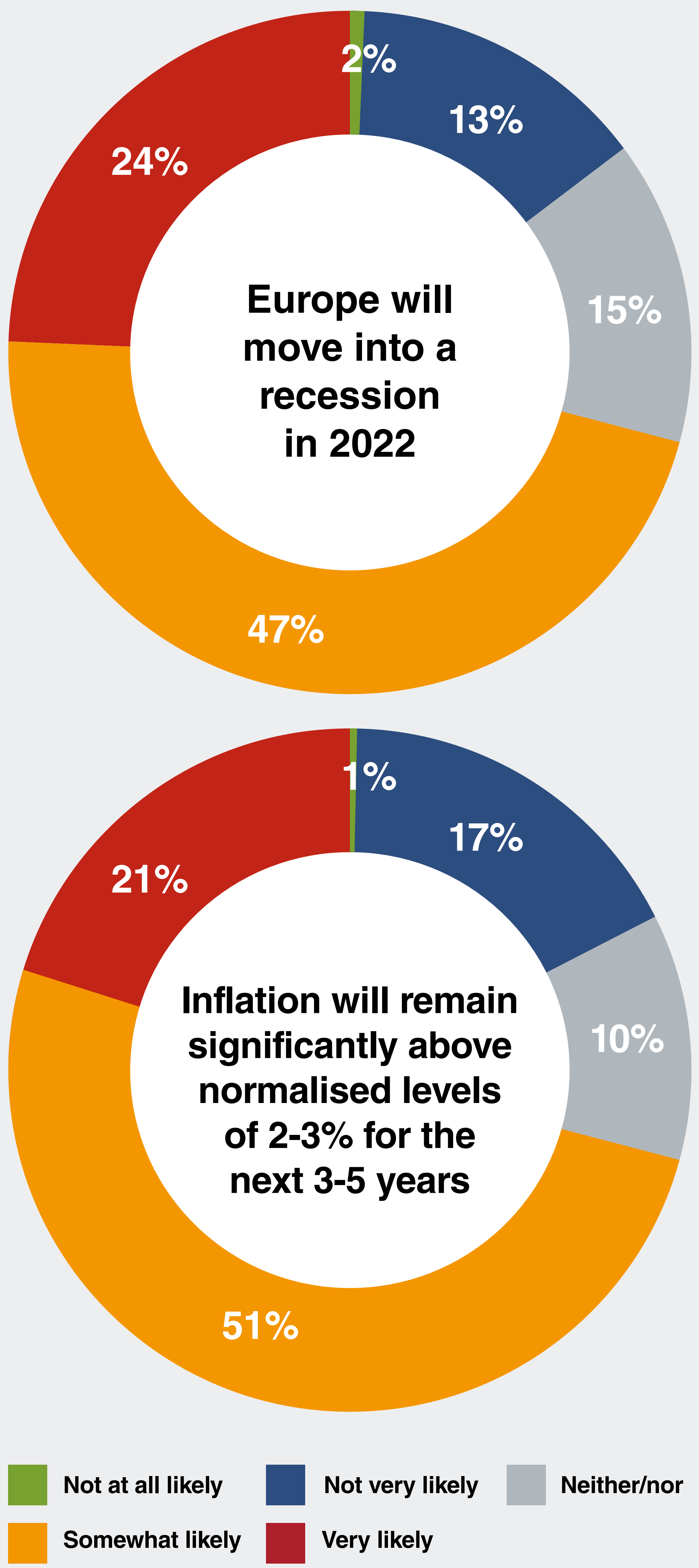
Industry leaders believe that liquidity will decrease farther in a market of lower investment volumes, rents and occupancies. Development will fall sharply. There is, though, more debate about the extent of any re-pricing.

Much depends on the severity and duration of the recession, and as interviewees point out, the economic circumstances and market conditions behind previous downturns are all quite different from what Europe is experiencing today.

“You’re looking at a 50-basis points correction for a mild recession scenario, where things just slow down,” says one fund manager. “But you’ve also got quite a lot of examples of downturns that became quite quickly more entrenched and exacerbated by other factors.”

In the GFC, one of those factors was the all-out disappearance of liquidity. Today it could be chronic energy supply shortages leading to black outs for homes or shutdowns in industries like steel production, which could lead to significant unemployment and reduction in economic output in some European countries.

Figure 3-1 **Expectations for the economy and inflation**



Source: *Emerging Trends Europe survey 2023*

Figure 3-2 **Primary drivers of a recession in 2022**

31% Continued high inflation

31% Continued high energy prices

14% Geopolitical event

11% Decreased consumer spending

9% Continued supply chain disruptions

1% Rising unemployment

Source: *Emerging Trends Europe survey 2023*

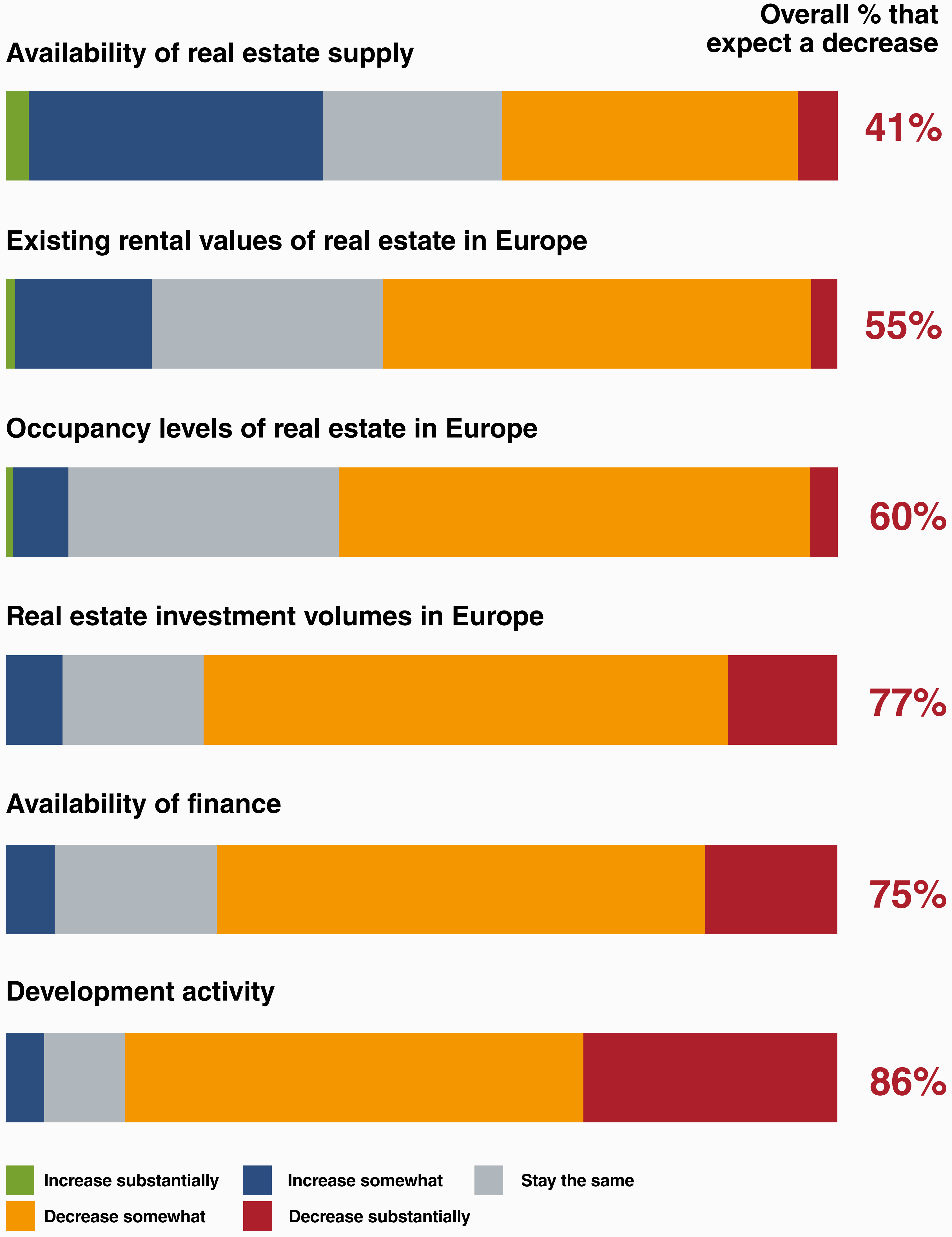
Though leasing activity held up reasonably well for much of 2022, interviewees are unanimous in their opinion that a recession will lead to occupancies and rents falling, even in previously strongly performing sectors.

As one investment manager says: “Once the recession hits, don’t forget some of these occupiers will stop paying their rent, some will leave that building, some will be coming back to us, saying, if you don’t give me a rent reduction, we’re going bust and we’re gone forever.”

With widespread forecasts of a decline in consumer spending, retail is likely to be first to suffer but with knock-on effects in the logistics sector. “With the consumer retrenching, I think occupiers are going to run down stock, saying, we don’t need that much more space right now, given the economic outlook,” an opportunistic fund manager says. “The drivers of underlying demand are just not going to be there, and therefore we need to put different rental growth assumptions into our models.”

> “The drivers of underlying demand are just not going to be there.

Figure 3-3 **The impact of a recession by the end of 2022**



Source: *Emerging Trends Europe survey 2023*

PREVIOUS CONTENTS NEXT

LONDON, UK

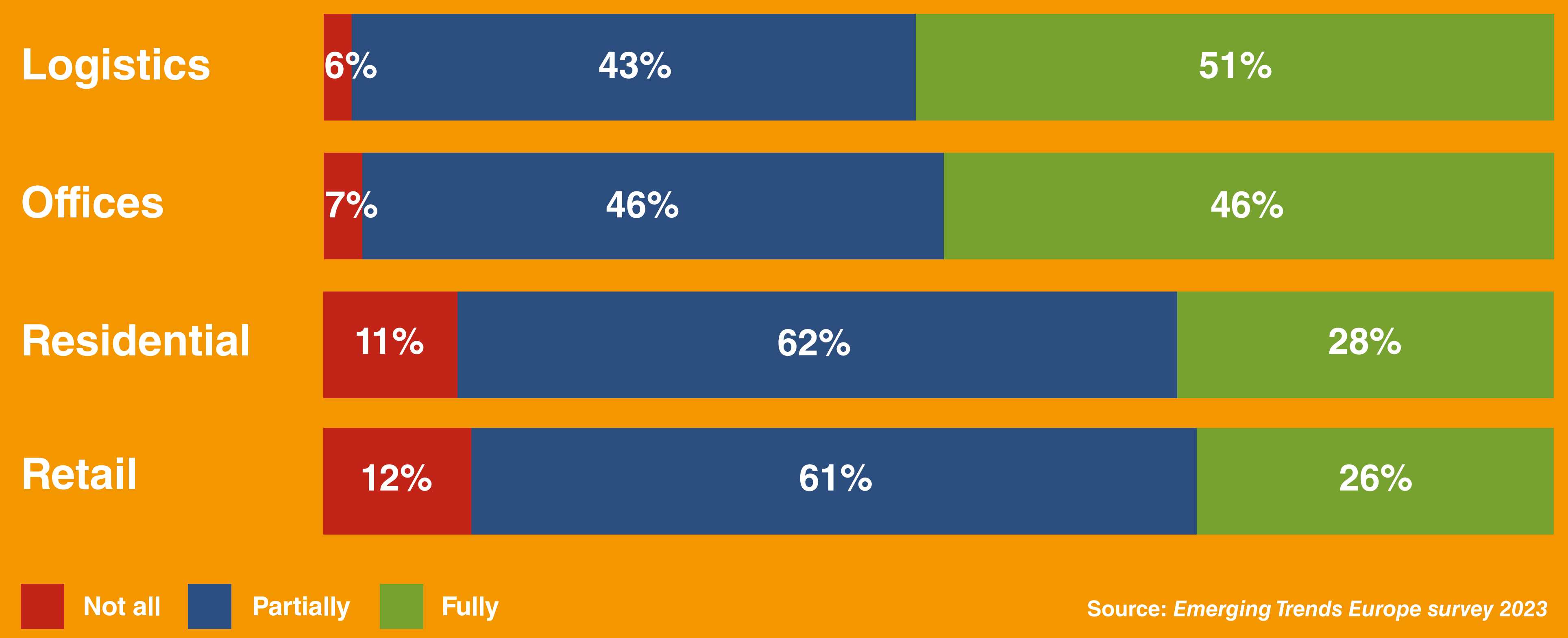
Figure 3-4 **Country transaction volumes, Q4 2021–Q3 2022 (€bn)**

Country	Q4 2020–Q3 2021	Displayed on map Q4 2021–Q3 2022	% Change
Germany	77	101	30%
United Kingdom	76	87	15%
France	35	39	12%
Sweden	25	28	11%
Netherlands	24	18	-23%
Spain	14	15	9%
Italy	10	13	29%
Denmark	11	11	-2%
Norway	9	11	22%
Poland	6	7	11%
Ireland	6	7	11%
Austria	6	7	5%
Finland	5	6	17%
Switzerland	6	5	-9%
Belgium	3	5	75%
Portugal	2	3	15%
Romania	1	2	42%
Czech Republic	1	2	62%
Slovakia	1	1	94%

Source: *MSCI Real Assets*

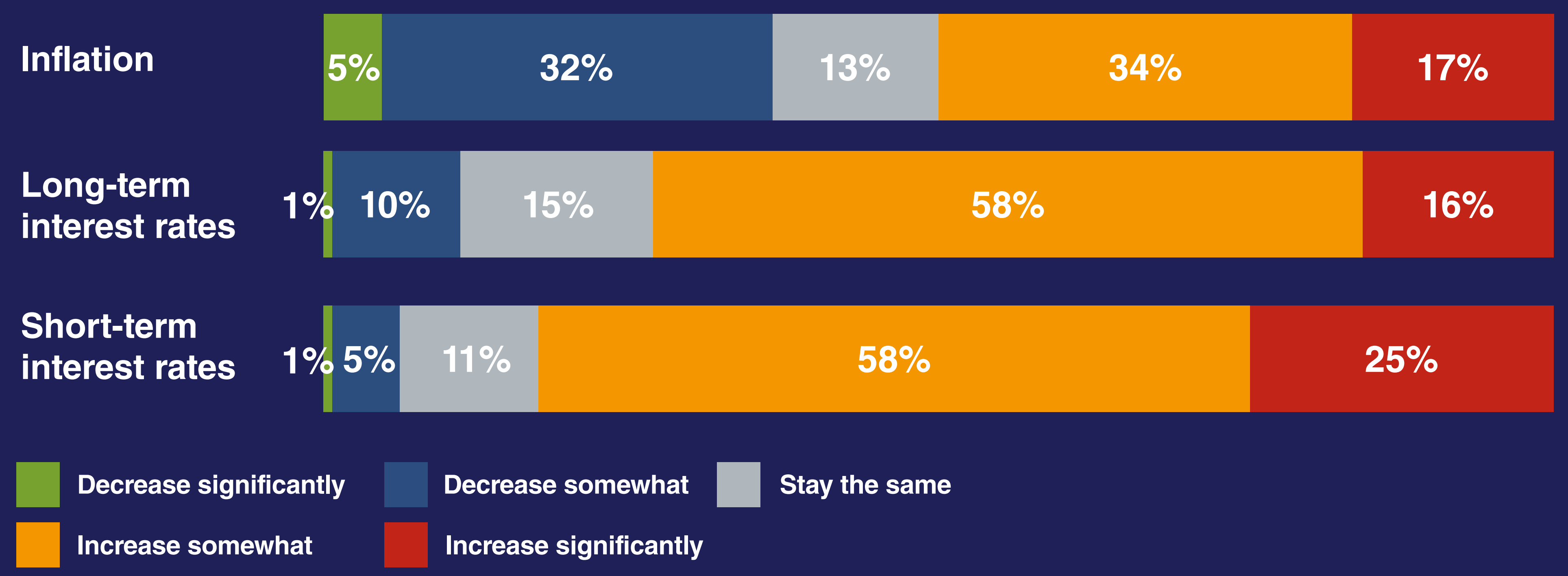
26% of respondents expect to be able to 'fully' apply indexation to their existing retail leases

Figure 3-5 **To what extent can indexation be applied to leases?**



Source: *Emerging Trends Europe survey 2023*

Figure 3-6 **Inflation and interest rates expectations for 2023**



Source: *Emerging Trends Europe survey 2023*

Inflationary pressure

The major influence on real estate sentiment is inflation at a 40-year high and the impact that has on economies and the actions of central banks.

Most industry leaders canvassed for this report agree that the prospects for real estate have not completely fallen off a cliff, at least partly because the asset class is long regarded as a hedge against inflation. The interviews and roundtables indicate this has attracted some investors in 2022.

But judging the correct response to prolonged, above-average inflation is certainly a matter of ongoing debate across the industry. For instance, more than half of survey respondents say they expect to be able to apply full indexation to their leases in logistics, falling to 46 percent in offices and closer to a quarter in the retail and residential sectors.

"Real estate only inflates when there's an undersupply of it," one global investor says. "You can inflate the top line rents in the same way that other consumer goods are inflating. So, logistics, residential, maybe hotels, they respond very well in an inflationary environment. But then poor-quality office and most retail is going to deflate rather than inflate."

At the same time, raising rents might not be enough to offset a rise in investment yields, a particular problem in sectors like logistics or residential where yields are very low.

"I'm not standing there saying real assets is great, it's the best inflation hedge, you should pile in," one global pension fund investor says, "because nothing's a great inflation hedge when interest rates are rising at the rate they're currently rising, off the levels of yields we've got in all real asset markets."

Though there is more occupier demand than supply in residential, especially at the affordable end of the market, the issue of raising rents in line with inflation in this sector is complex. Just because you can raise rents, should you?

"With this inflation, people may not be able to afford the rents anymore, making it a societal problem and a political issue," one pension fund investor says. "And that's when markets become distorted, when politicians start interfering."

"

With this inflation, people may not be able to afford the rents anymore, making it a societal problem and a political issue.

Capital pulls back

Central banks have responded to above-average inflation in 2022 with interest rate increases, and there is the prospect of more to come. After many years at close to zero percent, these base rate hikes ripple through every element of real estate capital markets, making the outlook gloomier than at any point in the past decade.

The survey signals a significant decline in capital for investment in 2023. Whether it is equity or debt, for new investments and refinancing or for development, more respondents think availability will decrease than stay the same or increase in 2023. As recorded by *Emerging Trends Europe*, confidence in the availability of debt and equity has not been this low since 2012 and 2009 respectively.

"We have a big open-ended fund in Europe, every quarter we're out raising new capital, and that has definitely slowed down," one investor says. "People are sitting there saying, well, we've had this overall financial market correction, so I just need to know where I'm at," an opportunity fund manager says.

Capital raising is likely to be challenging, regardless of source. Survey respondents believe capital from every part of the world is less likely to increase in 2023 compared with expectations last year. And there is no region where respondents feel capital is more likely to increase than decrease.

New opportunistic capital, typically from the US, will be in particularly short supply. But interviewees are generally paying more attention to the type of capital, the returns it is targeting, and the reasons it is investing in real estate, than its geographic origin. In this respect, it is clear that the interest rate rises by the Bank of England and European Central Bank (ECB) so far have hit different types of investors in different ways. For core investors, particularly pension funds and insurance companies, the rate rises have reduced the attractiveness of real estate compared with other asset classes, notably fixed income.

"The major insurance companies that were investing in real estate as a bond surrogate are pausing and saying, real estate is good, but why would I Invest in it at a 3 percent yield when I can buy good corporate credit at 2 percent?"

With real estate losing its advantage over bonds, whole markets can look unattractive, according to one fund manager active in rented residential: "We decided to move out of Poland, for instance, because the return on a Polish bond is higher than the return on real estate."

For pension funds and insurance companies, there is also the fact that falls in the value of their equity and bond portfolios can hinder the amount they invest in private real estate. This "denominator effect" means that an allocation to property, slower to be revalued than other asset classes, will increase relative to falling equity and bond values and prevent further investment.

Figure 3-7 **Availability of debt and equity in 2023**

Source: *Emerging Trends Europe survey 2023*

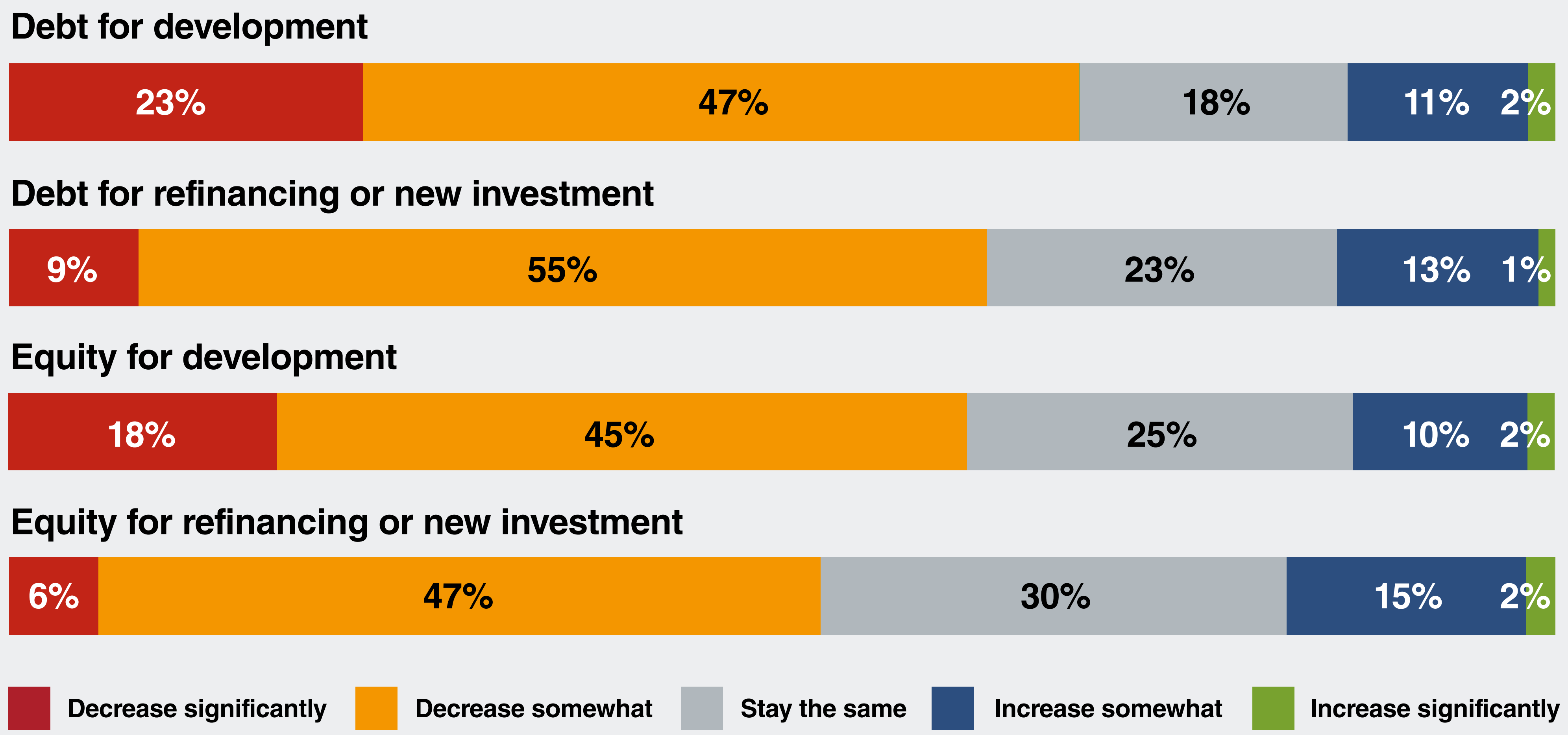


Figure 3-8 **Expected cross-border capital into Europe in 2023**

Source: *Emerging Trends Europe survey 2023*

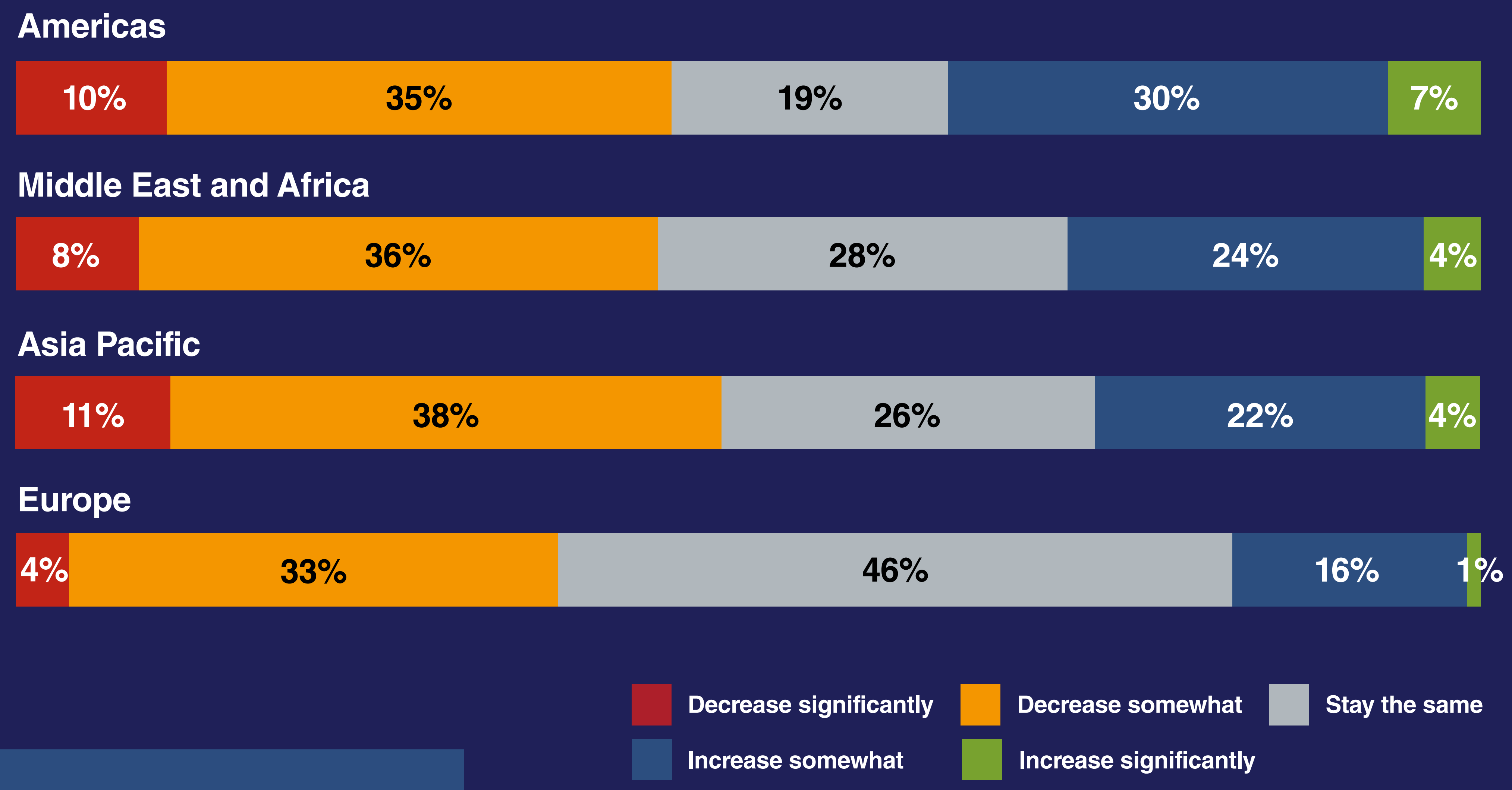
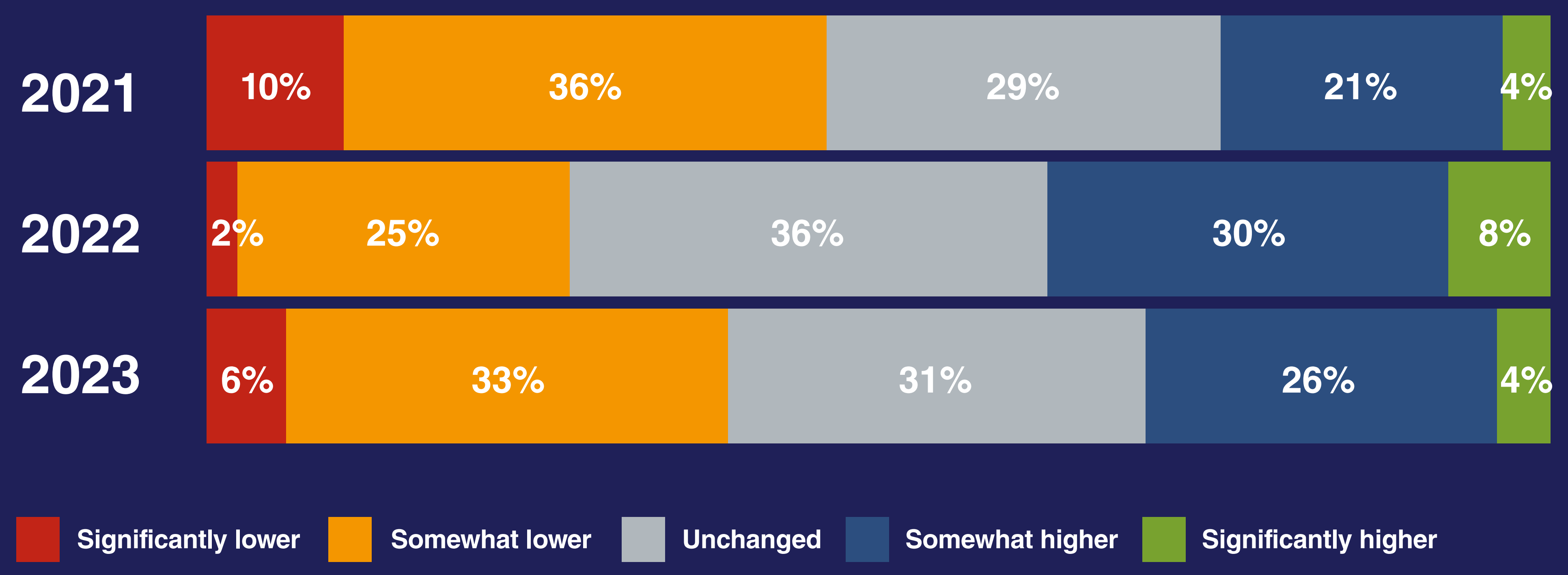
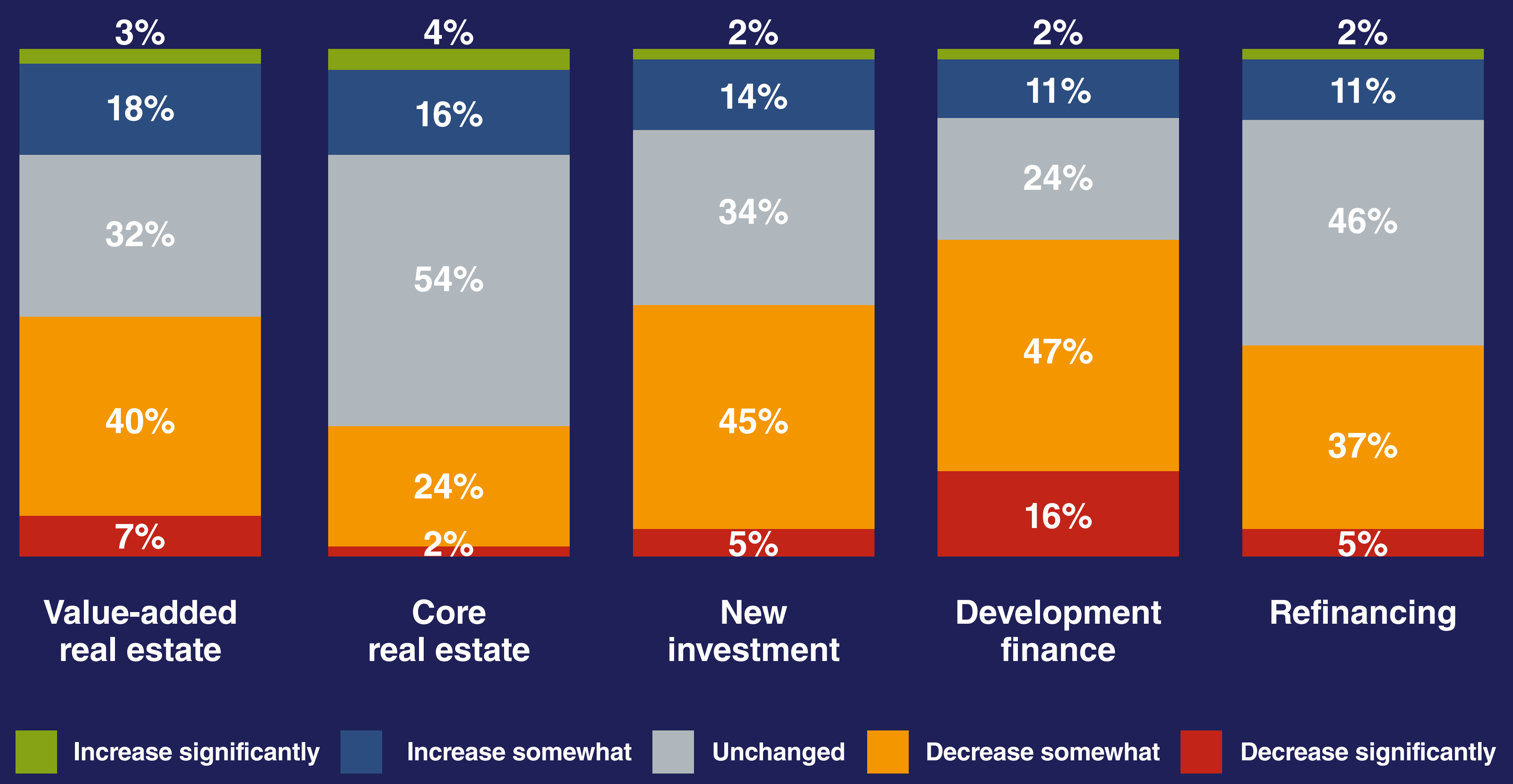


Figure 3-9 **Returns targeted compared with the previous year**



Source: *Emerging Trends Europe survey 2023*

Figure 3-10 **Expected ability to secure senior debt in 2023 compared with the previous year**



Source: *Emerging Trends Europe survey 2023*

"At the moment, if we want to do a new investment, we have to sell something else and free up money somewhere else, because of the denominator effect," one global pension fund investor explains.

It should be noted this is less of a problem for investors that split their allocation between listed and unlisted property – the value of their property shares has gone down too.

For investors that rely on debt, as interest rates rise, the price they pay for that debt also rises.

Consequently, the price they pay for an asset must fall for leveraged investors to hit their target returns.

As one listed company executive says: "Private equity is no longer capable of sharpening the pencil too much in pricing, because their access to debt is now hampered by the increasing debt costs."

Unleveraged investors are demanding lower prices because for the first time in a decade they can get equivalent returns elsewhere from less risky sectors than real estate.

Leveraged buyers are seeking to pay less because the cost of debt has gone up. Either way; this points to values falling further in 2023, which is at odds with survey respondents who say they have the same return expectations as last year.

> Private equity is no longer capable of sharpening the pencil too much in pricing, because their access to debt is now hampered by the increasing debt costs.

It is evident that the uncertainty spreading through economies and markets has worsened since the summer when the survey was conducted.

"We think everything's going to be worth less next year than it is this year," one bank lender says "Now, that's obviously a generalisation. There can be reasons why a particular asset would outperform. But if you just bought a relatively dry asset, we think it'll decrease in value over the next 12 months. So that makes it quite a challenging time to look at financing things."

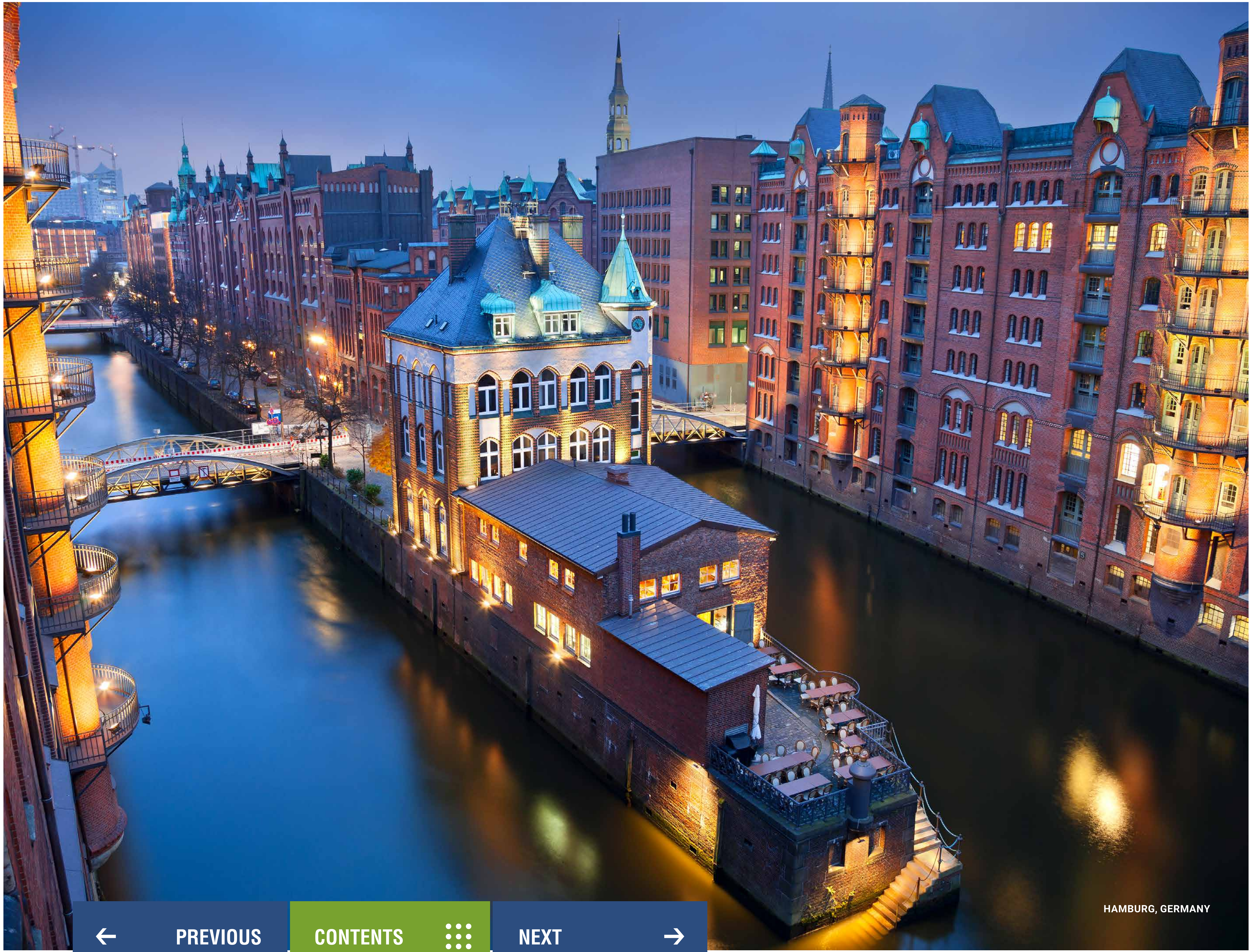
As one investment manager puts it: "If you were buying a deal last year, and you were trying to underwrite to a mid-teens or a high teens return, and that underwriting was predicated on a two and a half percent exit cap rate, you are done."

With values already falling, the coming year could be a great buying opportunity for core investors that are still under-allocated to the sector, one such investor points out. This would represent something of a shift from the last few years when, as highlighted in *Emerging Trends Europe*, the high price of existing prime assets led some investors to pursue "develop-to-core" strategies. Even so, those well-capitalised investors that still prefer the "develop-to-core" approach may yet benefit in a market where land prices will also likely fall and where competition among developers is expected to be in sharp decline.

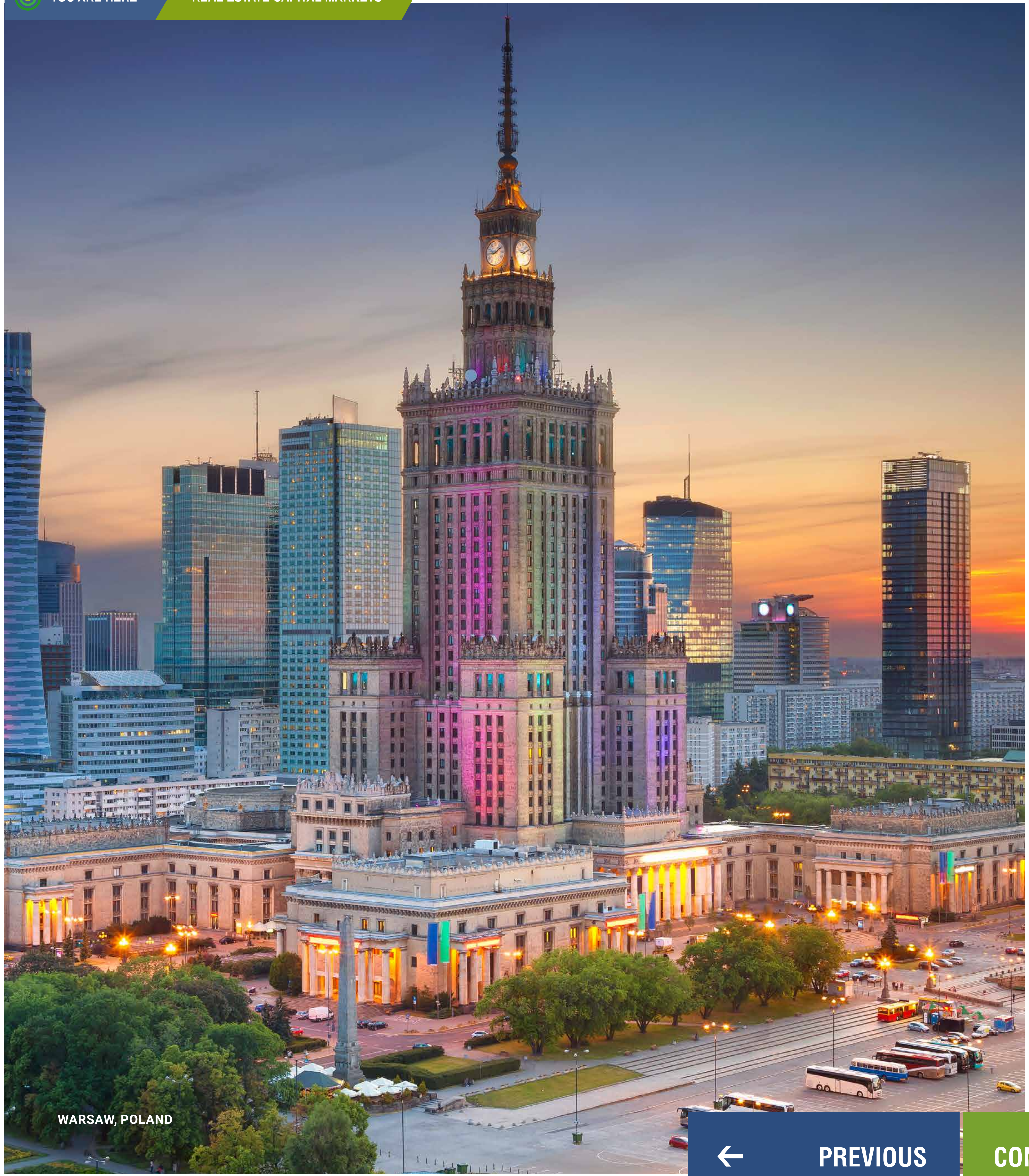
Right now, this is more theory than practice. Most interviewees are experiencing the sort of market logjam that occurs at all times of economic uncertainty, when buyers and sellers cannot agree on the price of assets.

"We're seeing very little volume because as usual, the buyers of real estate want to look forward because they have to own the assets tomorrow," one value-add fund manager says. "But the owners want to look backwards, because they owned it yesterday. That creates the bid/ask spread."

Another fund manager adds: "We might not be in this horror-show scenario of a deep and long recession. But we might be, and if you're investing now, you need some compensation for that in the form of higher returns."



HAMBURG, GERMANY



WARSAW, POLAND

Preparing for some form of distress

Most industry leaders express the hope that inflation will peak in the coming year, which would bring clarity over how much central banks are likely to raise interest rates. Assets might be worth less at that point, but there would be more direction over where values are likely to settle.

"You don't want to catch a falling knife," one global pension fund investor says. "You won't really see a lot of activity until one of two things happens: Until you start to see the inflation trend come down significantly, so you know where the Federal Reserve, the Bank of England and the ECB are going to go. Then I think you'll start to see people going back in."

But as that same investor adds: "If that doesn't happen, it's when you see a level of distress that people can say, okay, there's long-term value there.

The potential for distress has been a topic of great debate among both investor and lenders interviewed for this edition of *Emerging Trends Europe.*

The consensus view is that the level of distress is highly unlikely to reach the proportions of the GFC because leverage levels are so much lower – the industry has learned its lessons in the wake of the collapse of Lehman Brothers.

> "You don't want to catch a falling knife.

But the rise in interest rates will undoubtedly create stress, which means some owners will have to sell at a reduced level. As one value-add investor points out, much attention will be paid to investment deals completed in 2018 and 2019, which were the two highest transaction-volume years ever in Europe. "Much of that will have been funded with five-year loans, and those loans come due in 2023 and 2024. Those loans were made at a time of quantitative easing and we're now at a time of quantitative tightening, margins have blown out and the reference rate has blown out."

Those loans are likely to have been made at a loan to value (LTV) of 50 to 60 percent but falling values might mean those LTVs are now the equivalent of 70 to 80 percent, a level at which lenders may be reluctant to refinance.

More importantly, loans underwritten when interest rates stood at 1 percent will now have to be underwritten at rates perhaps three or four times higher. In other words, the ratio by which the income covers the interest payments will have dropped dramatically. And when a recession bites, occupier performance will be weaker, which could erode the income being used to pay the interest on loans.

Under such conditions, some borrowers might well put up more equity and pay down debt. But others may be unwilling or unable to do that — closed-ended funds, for example — and end up precipitating a sale.

And whereas banks were willing to "extend and pretend" after the GFC, the fact that the distress is not quite as acute this time might actually prompt them to push for sales more quickly.

As one fund manager says, loans went from 80 to 90 percent LTV up to 120 to 130 percent during the GFC and so "there was no reward for [banks] acting early. Now it has gone from 60 to 80 percent, they are not going to lose money in a sale, so it is the borrower's problem, not theirs."

The implication is that if borrowers choose not to put in more equity, sales are likely to come through much faster than in the post-GFC period. That will lead to price discovery, which could crystallise price falls for all asset owners.

Moreover, the Bank of England's slotting regulation and Basel III European banking rules, due to come into force in 2023, mean that it will become more expensive for banks to hold loans when LTVs rise, which will further incentivise them to push for sales.

There is another sign of falling prices — and the potential for capitalising on distress — and it comes in the form of the listed property sector.

The FTSE EPRA NAREIT index of real estate stocks in developed European markets fell over 40 percent from the start of 2022 until the end of September. Though property share prices partly reflect wider equity market sentiment, the index here indicates that stock market investors believe real estate values are going to fall. This could be seen as an opportunity by those investors that think stocks have already fallen further than the expected decline in the underlying assets.

"Loans went from 80 to 90 percent LTV up to 120 to 130 percent during the GFC and so there was no reward for banks to act early. Now it has gone from 60 to 80 percent, they are not going to lose money in a sale, so it is the borrower's problem, not theirs.

VIENNA, AUSTRIA

Lenders pull in their horns

Lenders' balance sheets are generally far healthier coming into this period of uncertainty than in the GFC. Even so, it is little surprise that survey respondents expect a decrease in finance in 2023 from all lenders, not just banks, compared with last year.

"One of the fundamentals is the overall cost of borrowing going up, even if we don't move margins, because we're now having to fund ourselves at a slightly higher level," one banker says. "Even if you look at banks who fund loans off deposits, they're having to pay interest on those deposits for the first time in a long time. So, everyone's cost of funds goes up, and that has to then get washed through the system."

It is also clear that lenders are seeing and addressing the same risks in the market as equity investors. "Most banks have effectively had to move their margins up," one banker says. "All the banks run risk models, and most of those risk models will have the probability of default, which is heavily influenced by the level where the rental income services the interest costs."

It is not quite the death spiral endured in the GFC, but there is a vicious circle in terms of the actions of lenders in the market. If transactions are down, fewer investors are repaying loans, and that means banks have less capital to make new loans. "The bank's balance sheet is not endless," says one interviewee, and the same is true for all lenders.

The bond market is also influencing real estate lending. Interviewees suggest that institutions like insurance companies that have been big lenders to real estate might now find it more attractive to buy lower-risk corporate bonds. Indeed, survey respondents are more negative about the prospects for new lending from pension funds and insurance companies than any other type of lender except banks.

But it also means that a financing avenue tapped by larger property investors, particularly REITs, is now effectively closed. As a consequence, they are looking to the traditional secured lending market again, reducing liquidity for everyone else.

"What we see is that some of our larger clients that typically would access the capital markets for funding don't have that alternative available to them anymore, so they've been coming to banks with quite sizeable requests for financing," one banker says. "But we've had to be selective. So, some of the newer names, or ones that are maybe a little less important from a franchise value standpoint, we've either had to say no, or we've managed the amount."

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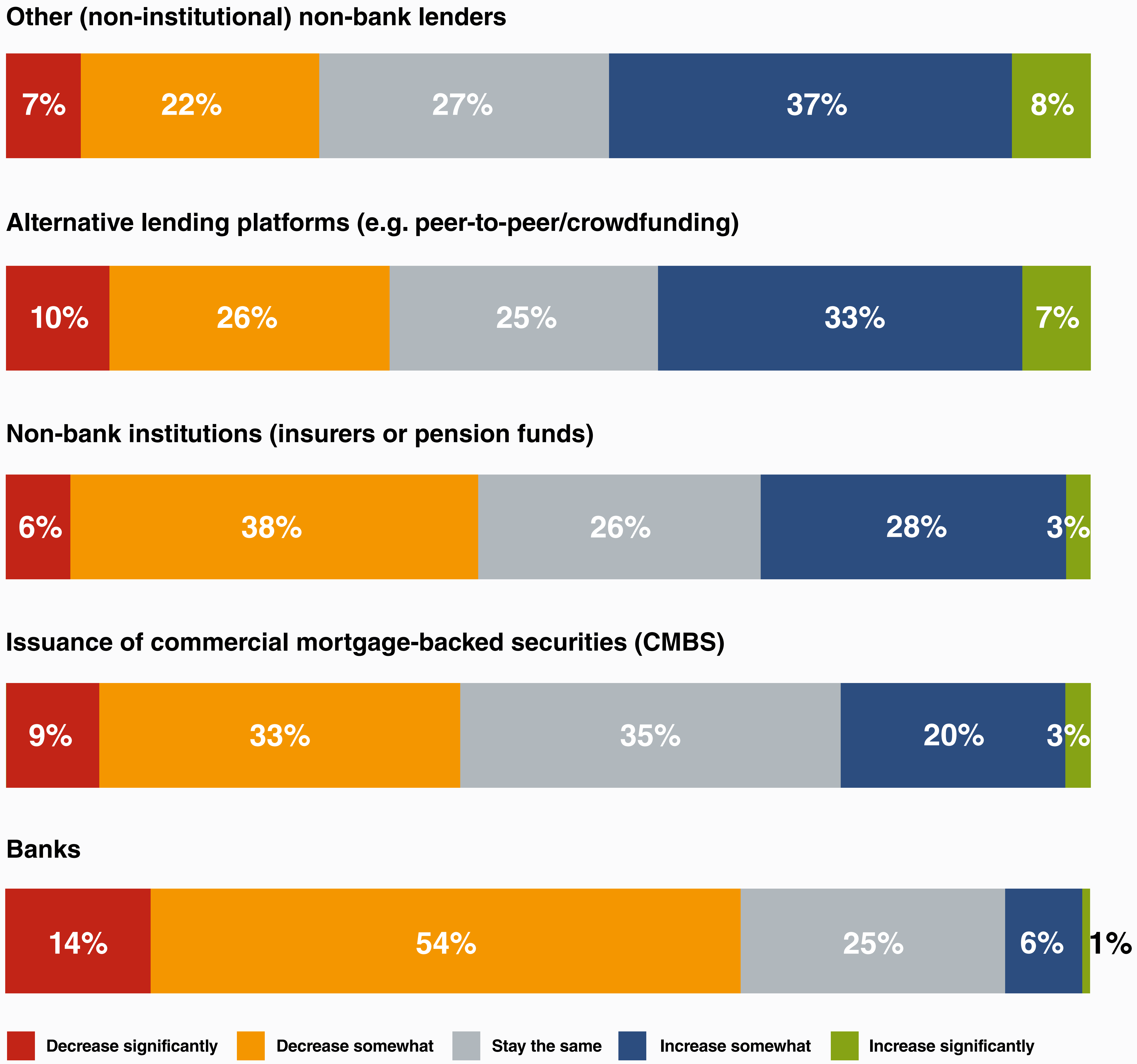
The bank's balance sheet is not endless.

Figure 3-11 **Expected availability of lending sources in 2023 compared with the previous year**



Source: *Emerging Trends Europe survey 2023*

"From a sustainability perspective, the rise in construction costs and the shortage of labour could not have come at a worse time.

AERIAL TOP-DOWN VIEW OF A SKYSCRAPER CONSTRUCTION SITE

Though they are likely to remain active, the debt funds indicate that what they are lending against is already changing significantly. With other lenders scaling down, the debt funds are, in effect, able to move down the risk curve but still make the same return. "Our debt guys are happier than I've seen them since we initiated the business, frankly. They've big grins on their faces," one fund manager says. "They are able to lend large tickets for fairly good collateral at 400 to 500 over. Sponsors are a little bit less price-sensitive than they might have been in a more robust market."

This shift supports the view among survey respondents that debt and equity for development will be significantly reduced in the coming year. But for lenders still considering development proposals, they are doing so in a much more risk-averse way, partly due to the uncertainty over rental growth in a fragile European economy but also because of surging costs of building materials and labour.

"We end up being comfortable with a smaller loan, and saying the developer needs to put up more equity to increase the cost overrun budget that they have," one debt fund manager says. "They might put something in and it looks fine in the normal environment, but we might say they have to double or triple that, because we're just nervous."

From the equity investor perspective, given higher construction costs and less certain income, the interviews indicate that projects slated for 2023 might be pushed back into 2024, or shelved entirely. As one fund manager says: "Every project is under review."

This lack of new development is seen by some as a positive for existing assets and their owners. "Coming into the year, there wasn't meaningful supply in many major markets, and then it's been shrinking visibly, because replacement cost has just literally moved up on everybody by somewhere between 20 and 40 percent," says one global player. "Either the rents have to be higher [to justify starting a project] or there's just going to be less development, both of which is good for owners of existing assets."

Such a view perhaps betrays a blind spot still among some in the industry when it comes to their obligations in meeting net-zero targets. While the decline in new development may be good for existing property owners in the here and now, finance still has to be found for the decarbonisation of existing assets through retrofitting or refurbishment. Failure to address climate risk raises the issue of obsolescence and stranded assets, which is covered in more depth in Chapter 5.

"From a sustainability perspective, the rise in construction costs and the shortage of labour could not have come at a worse time," one private equity investor says. "Target dates for countries to become net-zero haven't changed. The desire of investors to own the most sustainable assets hasn't slowed. But it's become much more difficult to undertake the changes necessary."

CHAPTER 4

SECTORS TO WATCH

“The rotation from traditional commercial real estate to other parts of the built environment is here to stay.”

UK fund manager

HIGH ANGLE VIEW OF PEOPLE ON SQUARE

With historically high energy prices and the prospect of shortages over winter, it is unsurprising that new energy infrastructure tops the sector rankings in *Emerging Trends Europe* for the second year in a row.

It is a niche pursuit, attracting little capital compared with mainstream real estate, and it is unfamiliar to many respondents. For some, investment in solar or wind power facilities or battery storage is more the realm of pure infrastructure investors than real estate players. But just as the largest managers combine divisions to become "real assets" investors rather than differentiating the two, so the survey signals how these worlds are merging. And in fact, some interviewees confirm they have started investing in battery storage as a real estate asset.

More broadly, the energy crisis has reinforced the need not just for countries to become more energy self-sufficient, but buildings too, which will advance the green agenda and make them more resilient.

It is perhaps stretching the definition, but new energy infrastructure could be taken to include existing assets. As one private property company owner explains: "We have to manage an energy turnaround. And it is my vision, my dream, that buildings will increasingly become small power plants; that buildings generate the energy they consume themselves and can also feed energy into the grid."

The top ranking of new energy infrastructure reflects the sector's role in one of the major challenges of our time - the transition to green energy. But it is also part of the wider, longer-term trend in which investors rebalance holdings away from the traditional big three sectors, particularly office and retail, towards previously alternative assets that will benefit from non-cyclical demand over the coming years.

Figure 4-1 **Sector prospects in 2023**

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

Overall prospects

Rank	Sector	Score
1.	New energy infrastructure*	4.45
2.	Life sciences	4.35
3.	Data centres	4.15
4.	Social housing	4.13
5.	Retirement/assisted living	4.12
6.	Affordable housing	4.10
7.	Self-storage facilities	4.10
8.	Logistics facilities	4.04
9.	Co-living	4.04
10.	Private rented residential	3.99
11.	Industrial/warehouse	3.98
12.	Student housing	3.97
13.	Leisure hotels	3.90
14.	Serviced apartments	3.77
15.	Parking	3.74
16.	Healthcare	3.72
17.	Housebuilding for sale	3.6
18.	Flexible/serviced offices and co-working	3.58
19.	Leisure	3.54
20.	Central city offices	3.34
21.	Retail parks	3.17
22.	Business hotels	3.13
23.	Business parks	3.04
24.	High street shops	2.94
25.	City centre shopping centres	2.68
26.	Suburban offices	2.62
27.	Out-of-town shopping centres/retail destinations	2.49

Investment

Rank	Sector	Score
1.	New energy infrastructure*	4.50
2.	Life sciences	4.44
3.	Data centres	4.38
4.	Self-storage facilities	4.24
5.	Retirement/assisted living	4.20
6.	Healthcare	4.16
7.	Logistics facilities	4.12
8.	Social housing	4.12
9.	Affordable housing	4.12
10.	Private rented residential	4.08
11.	Student housing	4.03
12.	Leisure hotels	4.02
13.	Co-living	4.01
14.	Industrial/warehouse	3.98
15.	Serviced apartments	3.83
16.	Flexible/serviced offices and co-working	3.72
17.	Leisure	3.67
18.	Housebuilding for sale	3.60
19.	Central city offices	3.43
20.	Retail parks	3.41
21.	Parking	3.39
22.	Business hotels	3.29
23.	Business parks	3.20
24.	High street shops	3.09
25.	City centre shopping centres	2.93
26.	Out-of-town shopping centres/retail destinations	2.72
27.	Suburban offices	2.71

Development

Rank	Sector	Score
1.	New energy infrastructure*	4.39
2.	Data centres	4.28
3.	Life sciences	4.25
4.	Social housing	4.13
5.	Affordable housing	4.08
6.	Healthcare	4.05
7.	Retirement/assisted living	4.04
8.	Self-storage facilities	4.03
9.	Industrial/warehouse	3.98
10.	Logistics facilities	3.96
11.	Private rented residential	3.90
12.	Student housing	3.90
13.	Co-living	3.83
14.	Leisure hotels	3.77
15.	Serviced apartments	3.70
16.	Housebuilding for sale	3.60
17.	Flexible/serviced offices and co-working	3.43
18.	Leisure	3.40
19.	Central city offices	3.25
20.	Parking	3.10
21.	Business hotels	2.96
22.	Retail parks	2.93
23.	Business parks	2.87
24.	High street shops	2.79
25.	Suburban offices	2.52
26.	City centre shopping centres	2.43
27.	Out-of-town shopping centres/retail destinations	2.25

Rents

Rank	Sector	Score
1.	Data centres	4.25
2.	New energy infrastructure*	4.25
3.	Life sciences	4.20
4.	Industrial/warehouse	4.14
5.	Self-storage facilities	4.09
6.	Logistics facilities	4.04
7.	Private rented residential	3.98
8.	Retirement/assisted living	3.94
9.	Co-living	3.90
10.	Leisure hotels	3.87
11.	Healthcare	3.87
12.	Student housing	3.83
13.	Affordable housing	3.82
14.	Serviced apartments	3.75
15.	Social housing	3.71
16.	Housebuilding for sale	3.58
17.	Leisure	3.53
18.	Flexible/serviced offices and co-working	3.50
19.	Central city offices	3.47
20.	Retail parks	3.21
21.	Parking	3.17
22.	Business hotels	3.06
23.	Business parks	3.05
24.	High street shops	3.02
25.	City centre shopping centres	2.82
26.	Suburban offices	2.77
27.	Out-of-town shopping centres/retail destinations	2.62

* e.g. solar, wind, energy storage, electric transportation

Source: *Emerging Trends Europe survey 2023*

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.

"The strong fundamentals that we identified some time ago, will still be there," one leading REIT executive says. "For example, in Europe, you have a demographic impact on the number of asset classes, like residential or healthcare, that will still be there in three to five years."

Indeed, various forms of housing dominate the top 10 picks from survey respondents, with healthcare in there too. Even student housing is benefiting from renewed positive sentiment in the rankings, moving to 12th place from 15th last year, after uncertainty about its prospects in the wake of COVID, with students now back on campus rather than learning remotely.

On a broad level, this is an acceptance that the balance between residential supply and demand in European markets has not changed in the past year, and it is unlikely to change any time soon.

While the security of income from residential is perhaps more certain than from commercial sectors like offices, the leap in construction and labour costs affects residential developers too, restricting supply while demand remains high.

"The housing crisis hasn't exactly gone away in most European cities," one global investment manager says. "If anything, supply is a bit more constrained and pricing is continuing to increase, and so rents are increasing."

Retirement/senior living is the highest rated of the residential sub-sectors for investment, up from seventh place last year, and among the top 10 for development, driven by the growing needs of an ageing population and the fact that COVID-19 showed a lot of older stock in the sector to be obsolete.

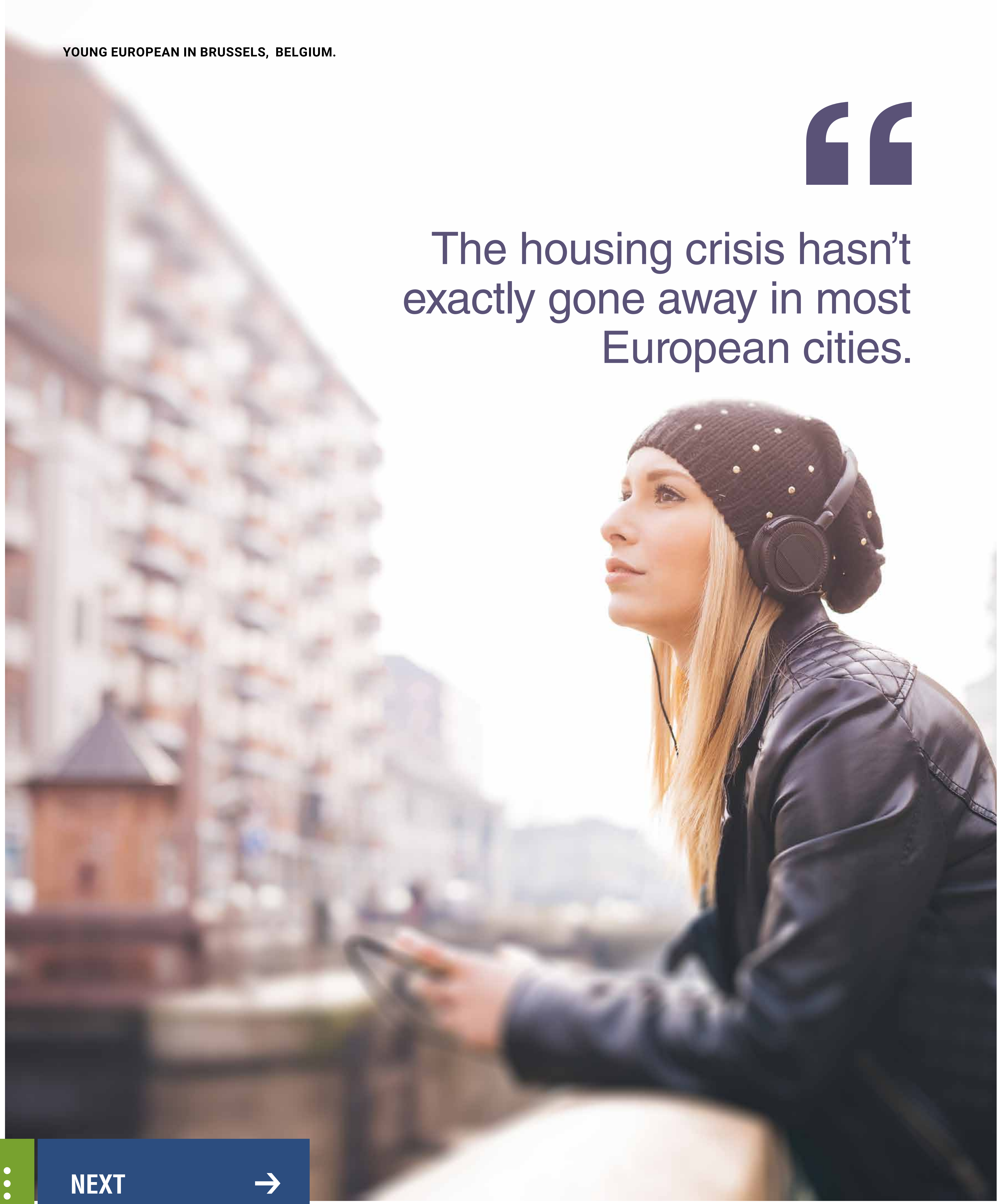
And social housing, in fourth place this year compared with 12th last year, has overtaken affordable housing, which sits at seventh place versus sixth last time. This requires some explanation. Respondents have marked up their investment and development prospects in recent years, given robust demand and a perception of solid income, often from government-supported rents. They also find favour among impact investing funds.

But they face many headwinds in the current economic environment. Of the prospect of increasing rents in sociable and affordable housing, one manager active in the field says: "I think it's really naive. If you follow the news, and you talk to people, families can't pay for the energy bill. I don't know what kind of rental increases you want to do against that background. Even if you can raise rents, should you?"

There is also what one global investor calls "stroke of the pen risk," given that governments can change regulation overnight in sectors seen as politically sensitive. The UK is considering capping rents in the social housing sector, for instance. "It should be the biggest part of our portfolio in the next 20 years, but it's so political," one global fund manager says.

Of the other alternatives at the top of the charts, data centres, in third place, continue to see increased demand for space. Some city and national governments object to the heavy energy consumption of data centres, signalling potentially stronger political opposition in future.

YOUNG EUROPEAN IN BRUSSELS, BELGIUM.



"The housing crisis hasn't exactly gone away in most European cities.

SUNSET IN MADRID, SPAIN

For the time being, however, industry players are swayed by the investment rationale. "Data is one of these things that has been growing exponentially, it will continue to do so, it's almost always true to say there's been more data created in the last two years than in the entire history of mankind before that," one REIT manager says, "and that continues to fuel a lot of demand for data storage and processing."

Industrial owners are looking to convert shed space to data centres, but interviewees say that, for now anyway, there are "finite" opportunities because of the size and specialised nature of the assets.

Life science is another sector that is small but growing fast, particularly in the UK, and rides high in this year's charts in second place.

"The dynamics in the true lab and office space are astounding, beyond belief," says one specialist investor, referring to the need for companies to cluster in certain kinds of space in certain locations, which currently are in very limited supply.

But again, the sector is small, requires specialisation, and, according to some interviewees, caution too. "Life science is something we're spending time on, we just need to make sure it really is life science and not just an old medical building that's now marketed as life science," an investment manager says. "But if it's the right kind of product, that's definitely something we're interested in."

One value-add manager warns of persistent market concerns over venture capital funding falling for life sciences companies and over the quality of covenants, arguing that there has been "far more hype for life sciences than there really was demand to meet that hype."

The outlook for hotels is bifurcated along predictable lines. Business travel is seen as unlikely to recover soon, and therefore the hotels that rely on business travellers will continue to suffer and remain towards the bottom of the table in 22nd place. By contrast, leisure travel has rebounded strongly in the wake of pandemic restrictions being lifted, releasing pent-up demand and rank higher in 19th place. Yet some interviewees are now waiting to see how the cost-of-living crisis will play out across Europe. "People are under-exposed to lodging, and they see a recovery," one global investment manager says. "But you have to question how long that recovery will last if people have to cut back on spending."

However, interviewees remain confident about the prospects for leisure travel in the medium to long term. "With the Gen Z, the millennials and emerging middle classes very much focusing on new experiences, we are looking at where these experiences come from, for example, travel and leisure," one global pension investor says. "That's an important area where this group will spend money. And where they spend money, we should be investing."

Logistics has slipped down the overall rankings from third to eighth place although still weighs in at seventh in terms of prospects for investment, and sixth for rental growth. Interviewees believe that while rental growth might slow from the historically high levels seen in some markets — 40 percent in the UK in 2021, for instance — demand still outweighs supply in all but a few markets – notably Madrid.

If there is a more downbeat view of the prospects for the sector, it is on the investment side. A sector that has seen yields compress to historic lows, sub 3 percent in many markets, is particularly exposed when values fall.

"One brokerage has come out with a latest valuation and over the last few months, they've pushed their yield on prime logistics out by 75 basis points," one European investment manager says. "When that starts at three and a half and goes to four and a quarter the implication on value is severe."

For investors that use debt, a base rate and margin which combined amount to 3.5 percent or more means you cannot buy logistics assets at 3.5 percent yields without essentially paying more in interest than you make on income. That means such investors are out of the market, reducing the weight of capital chasing the sector.

Retail occupies three of the four bottom places in the 2023 ranking of sectors similar to last year, with only retail parks rising out of the basement, partly due to the potential for them to become part of the logistics network of retailers.

Consumer and retailer confidence that was improving as COVID-19 receded has been hit by the spike in inflation.

Although European retail rents tend to be index-linked, the ability of owners to increase rents in line with inflation is far from guaranteed in a time of economic weakness.

And then there is office, which remains the largest sector of traditional commercial property in terms of extant assets, and one of the largest sectors when it comes to European investment volumes. But its prospects are no more certain going into 2023 than they were last year.

The various subsections have slipped down the rankings, with suburban offices in last position for investment prospects compared with 24th (out of 27) last year, and second last for rental prospects. The "hub and spoke" model of workers in dispersed offices appears to get short shrift from survey respondents.

"If you think that the benefit of office working is collaboration, then why would businesses have multiple locations and give people the option of going into multiple locations," one investment manager asks. "That doesn't make any sense. It's going to be central offices that can bring people together. It makes the pitch for suburban offices a lot harder."

"If you think that the benefit of office working is collaboration, then why would businesses have multiple locations and give people the option of going into multiple locations.

AERIAL VIEW OF A LARGE STOREHOUSE WITH SOLAR PANELS ON THE ROOFTOP

PEOPLE WORKING IN CO-WORKING SPACE

"

When you feel that you're working in a great space, you get that energy from it.

There is no consensus around where demand in a hybrid working world will settle. But there is consensus among interviewees, even stronger than last year, that the very best buildings will command premium rents and prices, with income and values falling away for the rest quite sharply. Environmental, social and governance credentials will form a major part of what defines the best buildings in 2023.

It is a market that divides opinion, and that is where big money will be made and lost.

"When you feel that you're working in a great space, you get that energy from it. "And there's more demand for that space than there is space available," one global investor says. "When people come into the office and it's substandard space, it's actually worse than working from home. And I think that replacement costs are so high, even regardless of the land prices, that no one's building anything. So, the actual supply/ demand dynamics for offices work, but it's all about stock selection."

Another global player explains the rationale behind "a huge investment" in a grade-A, "super-sustainable, amenity-rich", city-centre office building: "We may be wrong, but our feeling is that at rent review in five years' time, rents will go up because there is no comparable product."

On the flip side, others point out that the current difficulty in refinancing loans is concentrated on offices. This sector will see the most distress, and it is already causing concern among lenders.

Not only will the loans fall due as values drop and income cover ratios decline, the buildings themselves will need significant capital expenditure to render them fit for the future. Where that capital comes from is an open question.

"All the big changes and factors affecting real estate — technology, demographics, sustainability — they all collide in office," one global investor says. "The advance of e-commerce caused a huge migration of value from retail property owners to logistics. I think the shift in value from poor real estate to sustainable real estate over the next decade or so could be many, many multiples of that."

CHAPTER 5

FIT-FOR-PURPOSE REAL ESTATE

"In the post-COVID environment, I see a sense of place as absolutely essential to value creation, value retention, because if you don't enjoy going somewhere physically, you're not going to go there."

Global investment manager

BATTERSEA POWER STATION CONVERSION TO RESIDENTIAL IN LONDON, UK

Caught up in a whirlwind of long-term upheavals in demographics, climate change, technology and lifestyles, real estate faces a major challenge to be fit for purpose.

It is a challenge that involves changing the uses to which real estate caters while building in greater flexibility so it can remain useful over time — not to mention a transformation of its environmental sustainability and social impact. Set against this need for change, the pandemic and war in Europe have disrupted goods and energy supplies to create highly inflationary conditions, making real estate renewal much more expensive to achieve.

Yet the industry leaders canvassed for *Emerging Trends Europe* are looking beyond the short-term disruption to markets and regard climate change as the most important challenge for real estate over the next 20 years.

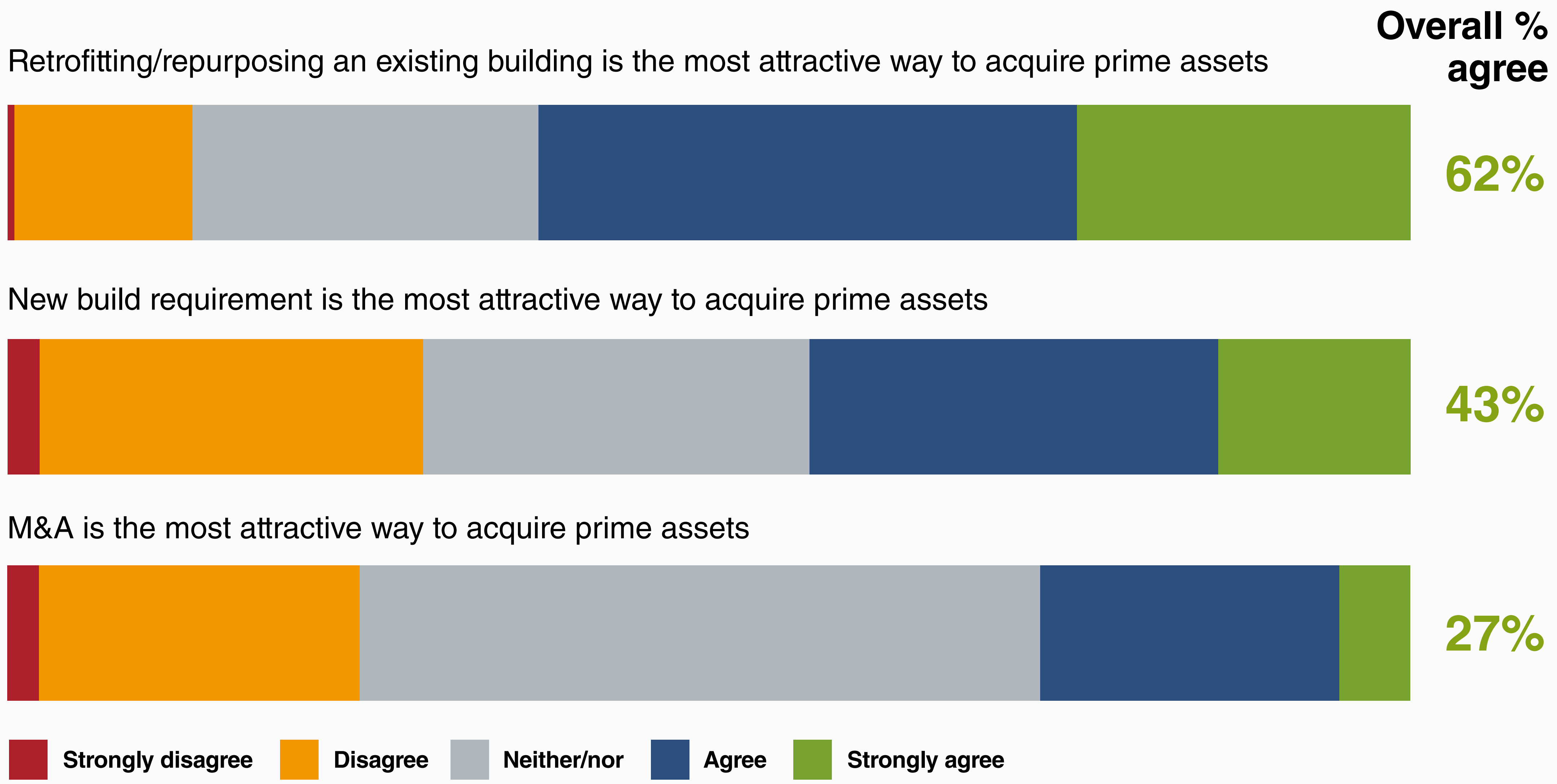
One European investment manager speaks for many when he refers to the need for a "structural reaction to climate change as a result of it demonstrating the failings in our stock. We're at the beginning of climate change as a driver of obsolescence, as a driver of capex, as a driver of complexity. ESG (environmental, social and governance), particularly the E element, has gone from greenwashing to being absolutely fundamental to investment success."

Others emphasise the impact of technology. "We are going through one of these great transitions in our sector," says one fund manager, "where a wide range of uses that were economically relevant for the past 30 or 40 years suddenly get changed by a shift in technology or demographics or some other exogenous factor. And that typically makes a lot of real estate obsolete."

The threat of obsolescence over the next five years concerns nearly half of survey respondents, even if other issues, notably construction costs, are front-of-mind in the shorter term. Moreover, environmental sustainability, one of the key factors driving obsolescence, is seen as a bigger immediate concern. The implication is that while surging construction costs are seen as a temporary hurdle, it will be impossible for the industry to overlook accelerating change in the demands of occupiers, the increasing influence of regulators and the climate agenda.

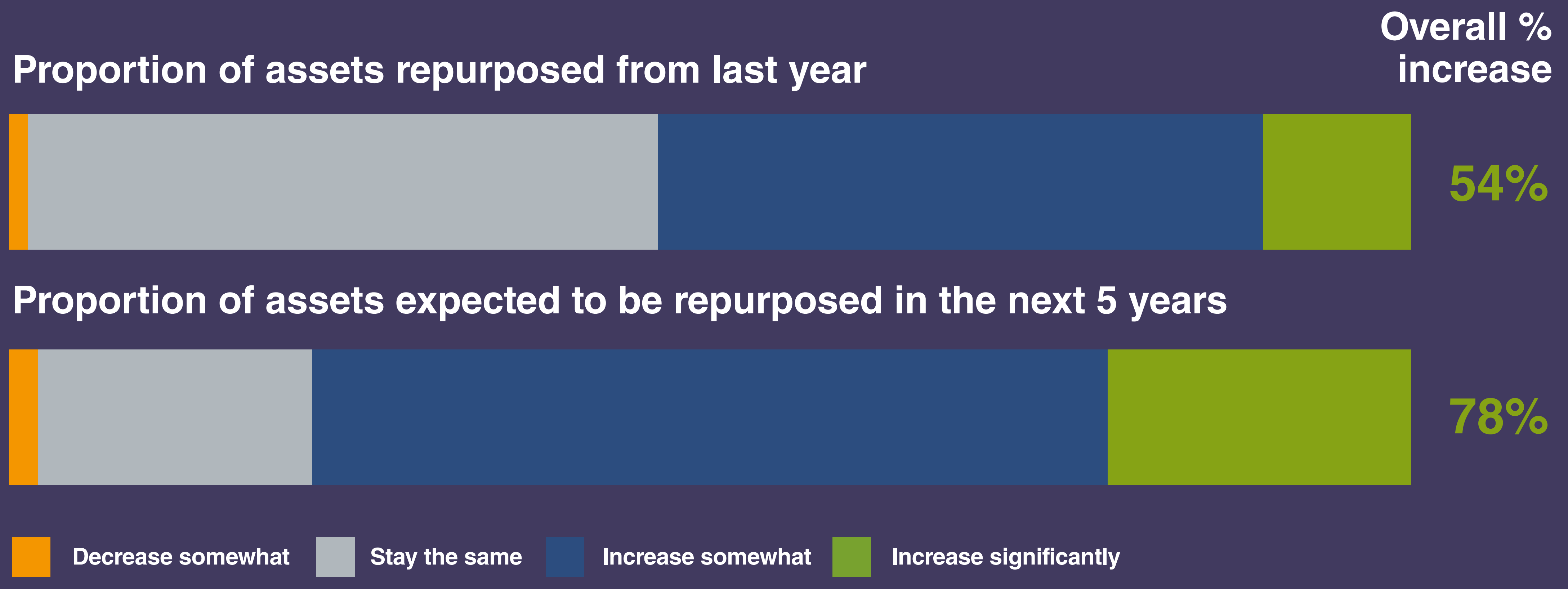
Part of the reason why obsolescence itself does not appear to be such a concern for 2023 may be due to uncertainty about exactly when its negative impact on values will start to bite. A UK-based manager notes that the theme of environmental obsolescence is partly driven by investors and partly by policy: "In the residential sector, for example, we are going to be unable to lease some flats based on EPC (energy performance certificate) thresholds in 2026, but parts of the market have yet to wake up to that as a capex issue. There's creeping policy-driven obsolescence."

Figure 5-1 **The industry's view on the most attractive way to acquire prime assets**



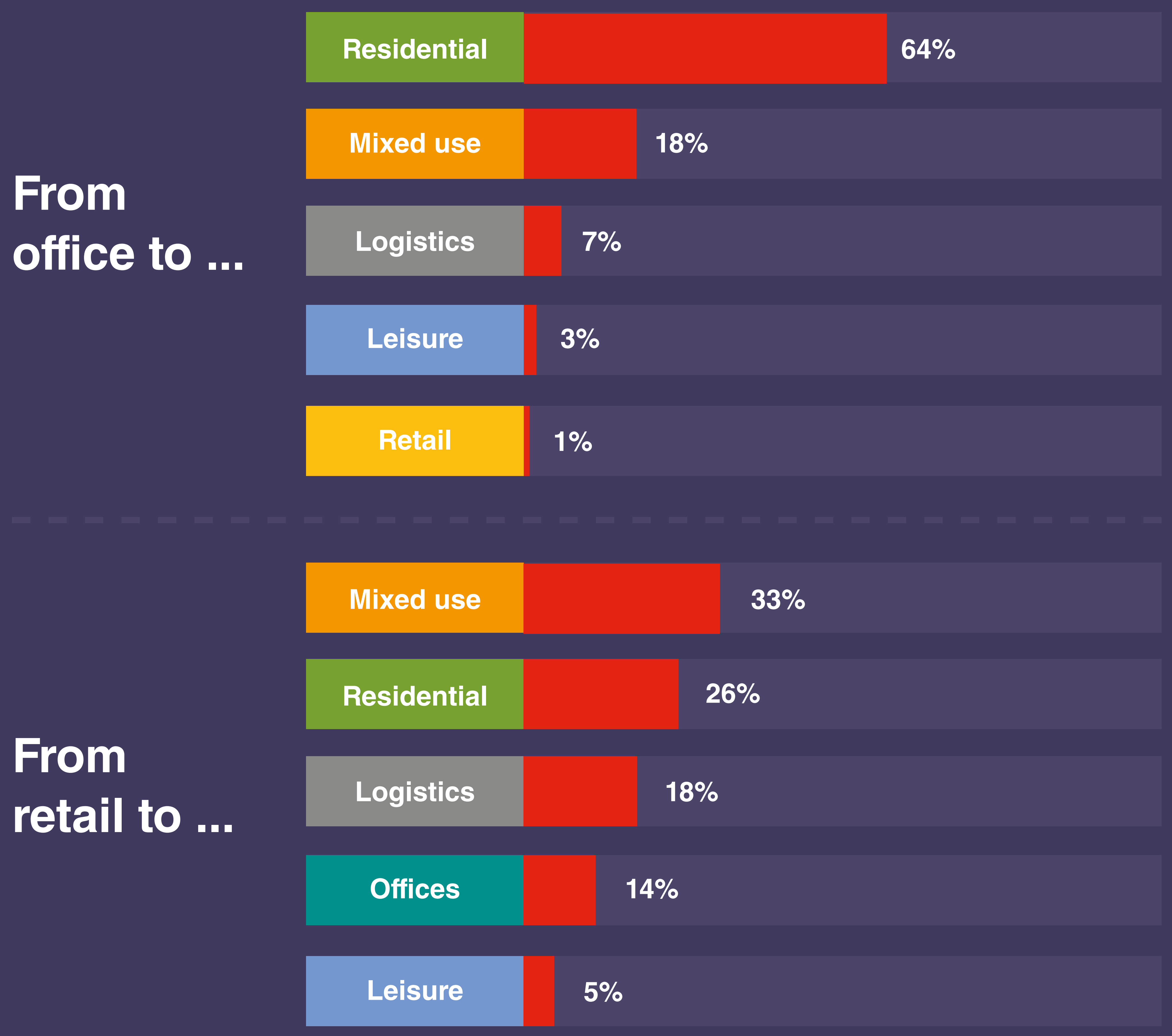
Source: *Emerging Trends Europe survey 2023*

Figure 5-2 **Observed/anticipated change in number of assets repurposed**



Source: *Emerging Trends Europe survey 2023*

Figure 5-3 **The most common change when repurposing an asset in the last year**



Source: *Emerging Trends Europe survey 2023*

The suggestion here is that there may still be a degree of denial in some parts of the industry. Interviewees acknowledge the failure of valuations to reflect sustainability-related capex requirements, even though 81 percent of survey respondents believe ESG credentials will have a material effect on asset valuations over the next 12-18 months. According to a pan-European manager, there is no sign yet of valuations for brown, or energy inefficient, buildings decreasing, or at least not sufficiently. Another manager laments the "lack of concrete guidance" on green premiums and brown discounts from the valuation standards authorities.

One large investor believes that poorer sustainability is "not yet factored into the valuation process" but adds: "We have seen that investors are no longer keen to invest in a sector, an asset or a fund without sustainability credentials and especially net-zero credentials. So, this is going to have an impact in the market and will accelerate."

Despite the uncertainty around valuation, most of the industry leaders interviewed for *Emerging Trends Europe* have clearly signed up to the fit-for-purpose agenda and are making long-term resources available to address it. "Most capex is to improve the quality of the asset without changing the use," says a major investor, "transforming office grade B to grade A, or grade A to net-zero. We are not investing only to improve the sustainability credentials of our assets but to improve their performance to extract value, which means better rent and better yields."

> We've almost certainly got too much office space, certainly too much of the wrong type of office space.

There is also an explicit recognition of how technology is accelerating obsolescence. One European manager notes that there is "a huge obsolescence issue" with offices. "We've almost certainly got too much office space, certainly too much of the wrong type of office space. The real issue now is whether office is going to be moving the same way as retail, in the sense that there's a fundamental change in the economic model."

And for offices' transformation to work financially, they will need to be in the right location. "Offices will continue to attract a lot of capital," opines a pan-European manager. "But they have to be the right offices, with the right layout, in the right location. This flight to quality in offices is massive. This is very much related with ESG because if you're not in the right location and your tenants can't support a higher rent, you're not going to be able to make the necessary investments to take that asset to the right level of energy efficiency, wellness for the employees, or to change the layout. And if not, there will be a lot of stranded assets across Europe that no one will buy because it's just not economical to retrofit them."

Another aspect of obsolescence relates to the whole concept of placemaking. This could imply a greater emphasis on buildings as part of an attractive and stimulating environment, attracting workers and residents alike. Some interviewees suggest that the whole industry must focus on creating the right kind of environment for tenants to move into, given that it's not something individual players can achieve alone. "Placemaking is more important than the building itself," says a pan-European manager, "and creating the environment in which the tenants can thrive—where people live, work and play—is super-important."

There is also a strong view that places need to be more flexible to cope with more rapidly changing occupational demands. This is reflected in the emphasis on repurposing to mixed-use in the survey responses but goes further than that. One residential operator notes that assets that target specific groups necessitate a high level of portfolio churn, whereas the objective should be to satisfy people where they are. In other words, "we need to create places where your home and area can evolve along with you. Digitisation can contribute to that."

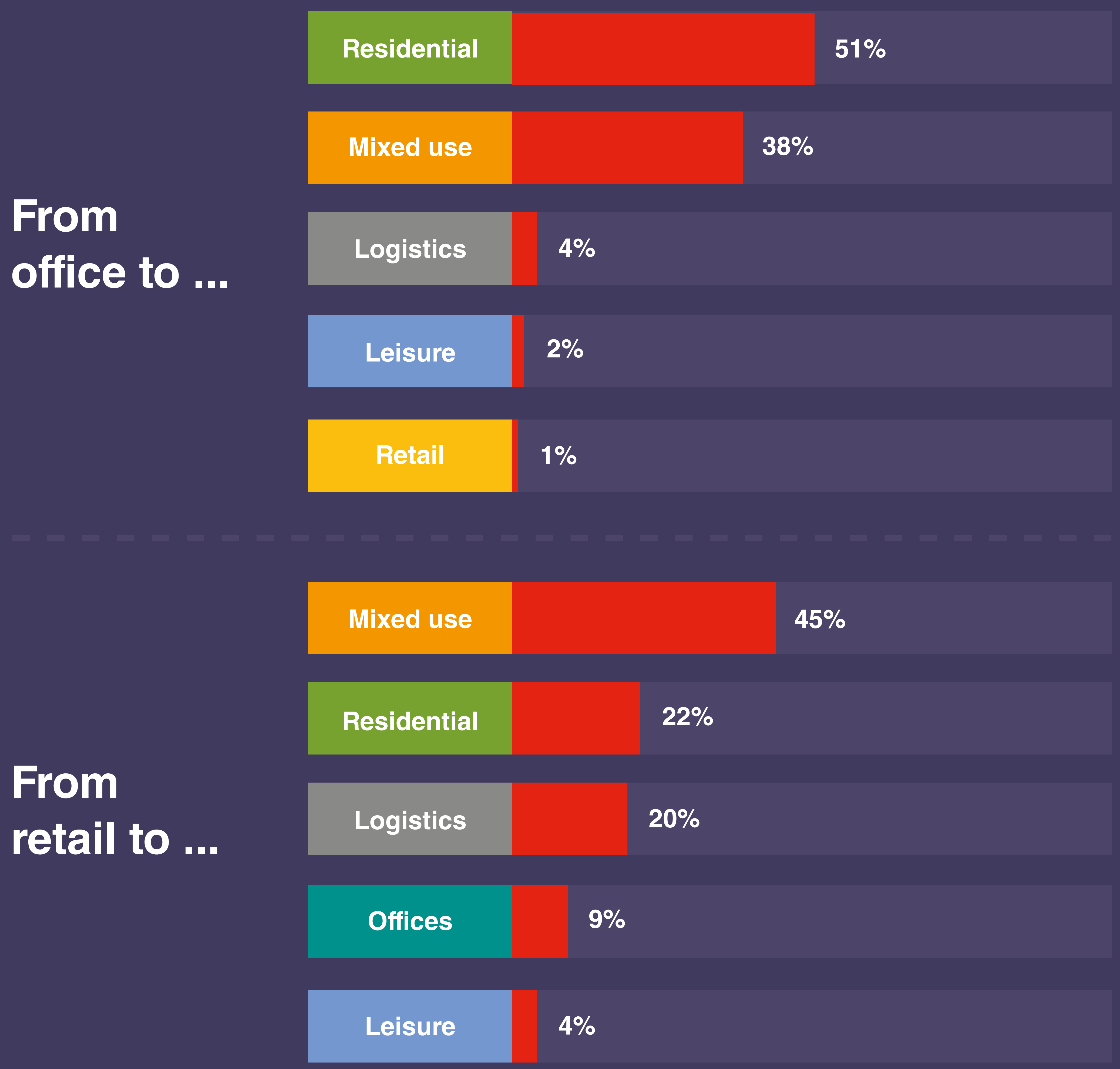
Local government also has a crucial role to play in creating places that are fit for purpose. Without a coherent vision it is difficult for the real estate industry to understand which projects will be permissible and how to meet the specific needs of the locality, whether developing from scratch or repurposing.

A developer-manager notes that "up to now, you've had a lot of independent actors pushing for pieces of cities. But when you can integrate that in a common view, it becomes much more powerful and much more doable."

Refurbishing or redeveloping existing stock can either involve reconfiguration to meet the changing needs of similar kinds of user or a complete change of use – in other words repurposing. As the survey makes clear, the motive here is not just about dealing with the threat of obsolescence: nearly two-thirds of respondents believe repurposing or retrofitting an existing building is the most attractive way to acquire prime assets.

The survey shows that repurposing existing stock from one sector to another is on an upward trend, with 54 percent of respondents repurposing more assets in their portfolio compared to the previous year, a figure that is up from 52 percent in the last survey. Likewise, more than three-quarters expect to be repurposing still more assets in five years' time, again up from last year's survey. Further impetus has come in cities such as London and Brussels where the planning authorities insist that developers fully explore the possibility of retrofitting before permitting completely new development.

Figure 5-4 **The most common change expected when repurposing an asset over the next three to five years**



Source: *Emerging Trends Europe survey 2023*

Last year, offices were most commonly repurposed, and mainly to residential. For retail, the most frequent change was to mixed-use, with residential not far behind. These trends are largely expected to continue over the next five years, though with logistics taking a growing share of retail space.

One French manager talks of repurposing "at an industrial level", adding: "We have a huge pipeline of residential coming from our office portfolio, often offices in secondary locations from sale and lease-back deals we did in the past. Now, those companies don't need those assets and are vacating them."

In Germany, office to mixed-use is also becoming more common, according to a European fund manager: "There's an absolute necessity for repurposing. We've seen a lot at a city or a property level, repurposing inner cities towards more mixed-use facilities with a higher quality. In our study of Germany alone, we found about 480 properties being transformed. The majority was office to mixed-use."

This may well be part of a more general trend towards greater flexibility of use, both within and across sectors, as seen, for instance, in the moves towards more of a service-type offering with offices.

Some interviewees acknowledge that the pace of repurposing across Europe may falter during current market conditions, in particular due to escalating construction costs.

One UK-based manager does sees this as a bottleneck, but more for the short term and in combination with other cost constraints: "At current construction cost levels we will not repurpose, but if they fall, then possibly. A lot of older offices and business parks are screaming to be converted to something else. But the land values need to go down sufficiently so that it makes economic sense to convert, and the planning system needs to be supportive."

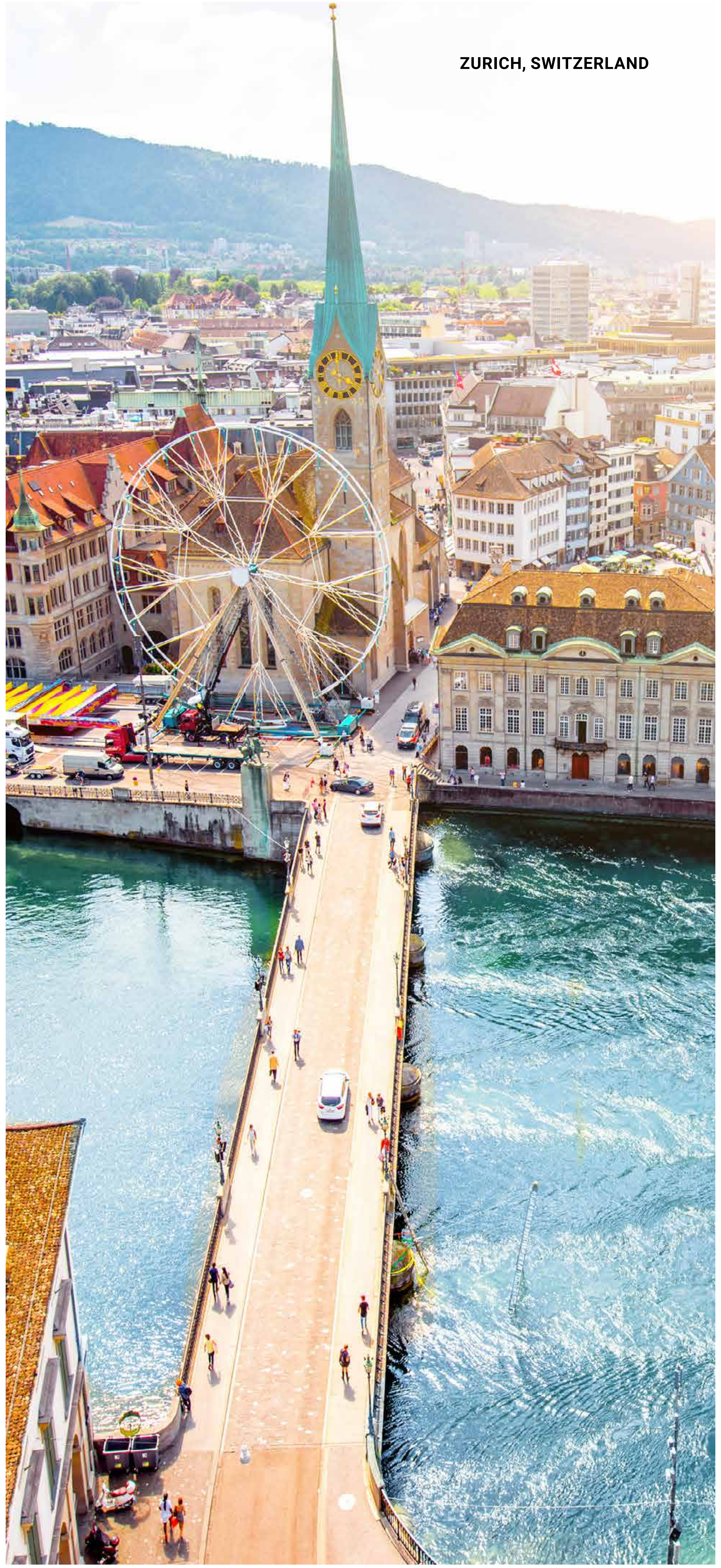
When repurposing from office to residential there is always the question of the relative rental levels in the sectors, which may require careful selection of locations. A global manager says that "a big UK theme is repurposing the office buildings that were next to rail stations in commuter towns. You're going to want offices in a central place that's easy to get to, vibrant, interesting and exciting, not in some random town."

Another consideration, according to some interviewees, is the time involved to get permits and the uncertainty surrounding that timing, which can be an issue for the value-add funds that may well be most interested in this activity.

Short-term constraints aside, the industry believes that keeping real estate fit for purpose will increasingly involve a blurring of the boundaries between traditional sectors or changing patterns of activity within buildings that may be considered to lie within the same sector.

> "There's an absolute necessity for repurposing. We've seen a lot at a city or a property level, repurposing inner cities towards more mixed-use facilities with a higher quality.

A global investment manager sums up this shift in approach to real estate: "We're doing more repurposing within sectors, but so dramatically that it's unrecognisable. Intensive office refurbishments are making it a different kind of sector. Tenants are also doing stealth repurposing within spaces. Retail park tenants are doing logistics in the same units. Office tenants are transforming the way they use space from a place where people sit and work to a place where people collaborate and enjoy some hospitality."



ZURICH, SWITZERLAND

CHAPTER 6

CITIES TO WATCH

"You still need to be in the big, key dense cities because those are the talent hubs. In a recession, you tend to see vacancy go to the secondary locations and the secondary quality stock. And when there's a lessening of demand, people migrate to the best-quality buildings in the best cities."

Institutional investor

BERLIN, GERMANY

With economic uncertainty afflicting the whole of Europe, overall investment and development prospects for all 30 cities covered by *Emerging Trends Europe* have deteriorated since last year's report.

Where last year there was a unifying, pan-European recovery from the economic consequences of COVID-19, this year's survey and interviews reveal a much more fractured response to highly challenging market conditions — and significant differences in the potential resilience of the cities.

Varying prospects for inflation between countries relating to their dependency on fossil fuels for energy, divergent interest rates and distance from the war in Ukraine all play their part. These factors are impacting cities' ongoing economic performance and their forecasted real estate returns, two of the top three considerations influencing survey respondents when deciding where to invest or develop.

In tandem with these influences, the disruption to patterns of life that accompanied the pandemic has modified the function of cities and the demands on real estate there. In this evolving environment, national and international transport connectivity is also seen as a key influence, and is particularly relevant for those cities that have risen up the rankings this year, notably Paris, Madrid, Lisbon and Copenhagen.

For the second successive year, London remains the most favoured city in Europe for its overall prospects, especially for offices and logistics. Retail and hospitality are also well supported by the revival in tourism. Sentiment is buoyed by the perennial attractions of a wide and deep market.

There are, however, also nuances in demand for London's office districts as working patterns change post pandemic. One global fund manager observes that "if you don't enjoy going somewhere physically, you're not going to go there. We see it dramatically in London, with the return to work being most robust in the West End, less robust in the City and weaker in Canary Wharf."

The depth of London's investment market reflects the extent of its broader metropolitan area, something that is only rivalled in Europe by Paris, which takes over second place from Berlin this year.

The French capital's strong transport links once again find favour with industry leaders, but they are also anticipating a boost from the 2024 Olympic Games. And importantly, France is seen as having a relatively resilient energy supply, mainly due to its nuclear generation, which contributes to a lower carbon footprint for real estate operators.

Figure 6-1 **Europe's 10 most active markets, Q4 2021–Q3 2022 (€bn)**

Country	Q4 2020–Q3 2021	Q4 2021–Q3 % 2022	Change
1. London	26	32	23%
2. Berlin	16	30	86%
3. Paris	20	22	8%
4. Stockholm	10	12	22%
5. Munich	8	8	-3%
6. Madrid	4	6	49%
7. Frankfurt	9	6	-35%
8. Hamburg	5	6	20%
9. Dublin	5	6	13%
10. Milan	3	5	50%

Source: *MSCI Real Assets*

Figure 6-2 City rankings - Overall prospects

Overall prospects			
Rank (2022)		City	Score
1 (1)	—	London	2.15
2 (3)	▲	Paris	1.72
3 (2)	▼	Berlin	1.69
4 (6)	▲	Madrid	1.54
5 (5)	—	Munich	1.49
6 (7)	▲	Amsterdam	1.48
7 (4)	▼	Frankfurt	1.30
8 (8)	—	Hamburg	1.19
9 (9)	—	Barcelona	1.12
10 (11)	▲	Milan	1.10
11 (16)	▲	Lisbon	0.98
12 (12)	—	Vienna	0.93
13 (13)	—	Dublin	0.92
14 (18)	▲	Copenhagen	0.80
15 (10)	▼	Brussels	0.78
16 (15)	▼	Warsaw	0.77
17 (14)	▼	Zurich	0.71
18 (20)	▲	Manchester	0.70
19 (19)	—	Stockholm	0.68
20 (17)	▼	Luxembourg	0.63
21 (21)	—	Rome	0.62
22 (22)	—	Birmingham	0.48
23 (23)	—	Athens	0.47
24 (26)	▲	Lyon	0.45
25 (24)	▼	Helsinki	0.44
26 (27)	▲	Edinburgh	0.42
27 (25)	▼	Prague	0.42
28 (29)	▲	Budapest	0.31
29 (30)	—	Istanbul	0.26
30 (28)	▲	Oslo	0.24

▲ Went up ▼ Went down — No change

Source: *Emerging Trends Europe survey 2023*

Note: Respondents who are familiar with the city scored the expected change for 2023 compared to 2022 on a scale of 1=decrease substantially to 5=increase substantially and the scores for each city are averages. For more detail on city scores, see appendix.

"The quality of the city is improving; the slow traffic, bicycles, walkways, greenery, the use of public space are all improving it tremendously," says a Dutch investor. But like in London, offices need to be in the right location in Paris. Another investor suggests that "peripheral locations will suffer because their offices have a DNA that won't work in the future — large office buildings which are not centrally located."

Berlin has slipped one place down the rankings this year, and like most German cities, has registered one of the larger reductions in scores across Europe — no doubt reflecting the country's dependency on Russian gas supplies and the potential impact on inflation and the wider economy.

But the city still attracts the enthusiasm of many market players, and stands out from the other German cities covered in the survey, with pricing viewed as relatively competitive, and offices seen as less location-sensitive than many other cities: "You can go out of the CBD. The market is really broad, and the vacancy rate is still at 3.5-3.7 percent right across the city, so you can invest almost everywhere."

As one of the fastest growing cities in Europe, Madrid rises from sixth to fourth place. Urbanisation is continuing apace, seemingly unhindered by the pandemic, due to inward migration from elsewhere in Spain and from overseas.

Spain is also set to benefit from strong growth in wind and solar power over the next few years, potentially insulating the economy from energy disruption and helping move real estate towards net-zero.

Residential investment in particular is viewed as promising given a perceived shortage of supply. As one developer notes, prices are rising as a result of the scarcity of ready-to-build or fully permitted land: "The pricing dynamics for those that have land and can build are good and will remain good." Similar supply-demand dynamics are reinforcing the office and logistics sectors here.

Although the German cities remain in the top 10 there is not quite the same unwavering positive sentiment as in previous years. Frankfurt slips three places to rank seventh in the survey, again reflecting Germany's vulnerable energy position. Interviewees still see Frankfurt, Munich and Hamburg as resilient in the long term, but only accessible at a price.

One investor characterises Munich, at fifth place, as "a mature market, which is already expensive, so you cannot expect head room to increase rents and value." Institutional investors appear to be limiting their target allocations here, with one noting that some may now even want to reduce their exposure, "given the energy crisis and the political environment" in Germany. Frankfurt has some relatively new niche sectors such as data centres, but even these may now be approaching investor saturation. Meanwhile in eighth place, Hamburg is seen as "losing importance as a port city" while proving "complicated" for residential investment.

Amsterdam remains highly attractive, rising one place to rank sixth, based on its strong economy and a reputation for liveability. The city has a history of repurposing that has helped rebalance the volumes of office and residential stock, with vacancy levels relatively low across the board. The municipal government also has an explicit commitment to sustainability via "doughnut economics", which aims to provide all citizens with the essentials of life without damaging the planet – the first European city to do so.

Ranked ninth, Barcelona shares many of Madrid's positive attributes, including similarly rapid population growth. One international developer-investor says that offices and logistics are performing extremely well here but that while residential demand is strong, builders face a challenging target of 30 percent subsidised housing. "In certain locations that makes sense, but in others that aren't in the city centre, it doesn't."

Milan is also regarded favourably, as reflected in its ranking of 10th. An asset manager commends the opportunities in a wide range of emerging sectors there: "themes that we really like, like leisure, living, and the senior economy." At the time of the survey Italy's economy was growing faster than Germany or France, although the outlook for 2023 now appears less favourable as political and economic risks start to show through in rising government bond yields.

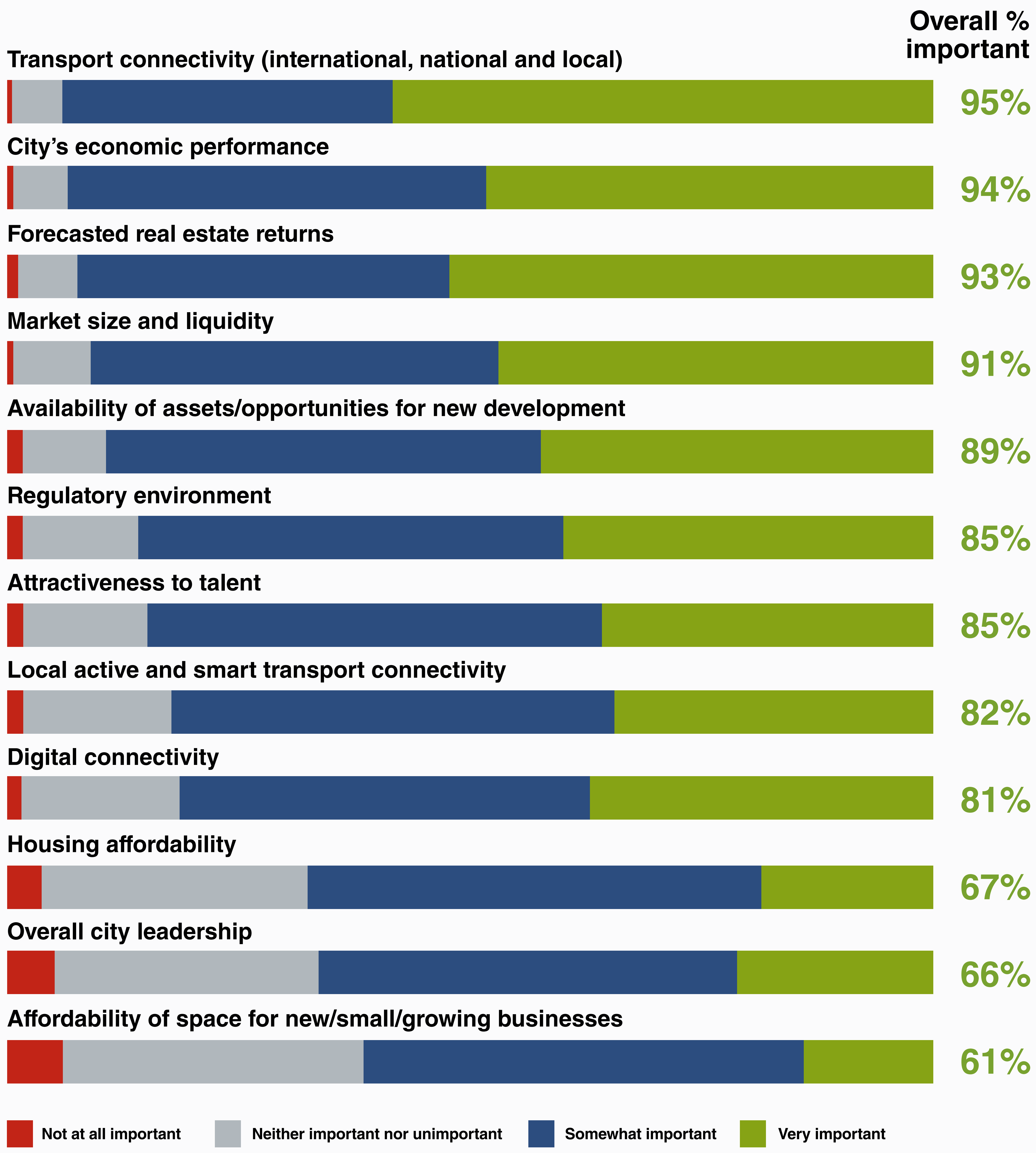
Lisbon stands out for rising most against last year's position, from 16 to 11 in the survey. The city seems to be bucking the trend in most other markets, with demand still strong internationally, even if local capital may be receding. "Resi is the market star at the moment, attracting buyers from all over the world," says a local player, and it remains relatively easy to build across the city.

The war in Ukraine is clearly having a particular impact on cities in Central and Eastern Europe. Ranked highest among these at 12, Vienna has seen an influx of new residents, with growth in the number of single households. Ranked 16, Warsaw is seen as benefitting from increased residential demand in the short term although the proximity to the conflict is spooking many investors. The volatility of costs from sitting outside the Eurozone is also moderating sentiment towards an otherwise resilient Polish economy.

Prague and Budapest remain low in the rankings, 27 and 28 respectively, largely due to their limited liquidity. However, international players praise the former for its strong rental growth prospects and a great sense of place, while the latter benefits from a more favourable energy situation than most in Europe due to Hungary's positive stance towards Russia.

Two European cities benefit from specific tax advantages or political status. Ireland's commitment to the lowest corporate taxes in the EU undoubtedly supports Dublin's ranking at 13. And as a local fund manager points out, "after Brexit, there is added demand from occupiers of logistics units because they are trying to avoid the UK". Luxembourg, meanwhile, slips down three places to 20, with one international manager pointing out that the EU is looking to curb its tax-haven status.

Figure 6-3 **Importance when selecting a city for investment or development**



Source: *Emerging Trends Europe survey 2023*

14 ↑ Up 4 places

Copenhagen

Copenhagen stands out as potentially the most resilient in current conditions, climbing four places to 14. The city is seen as low risk with low interest rates and a growing number of international investors.

COPENHAGEN, DENMARK

Among the Nordic capitals, Copenhagen stands out as potentially the most resilient in current conditions, its attractiveness score having fallen less than most. Climbing four places to 14, the city is seen as low risk with low interest rates and a growing number of international investors adding liquidity in recent years, taking advantage of a currency pegged to the euro. In the context of the incipient energy crisis, Denmark's capital is less gas-dependent than Stockholm and Oslo.

At 19, Stockholm is seen as having a very strong residential market, but one that may have become overpriced. Helsinki's closeness to Russia counts against it in the short term although one Nordic developer-manager believes the city, ranked 25, is "underrated from an investor point of view", given its strength in technology and renewable energy usage. At 30, Oslo is the lowest ranked city although it is largely off the radar for most international investors given the dominance of local players, while the Norwegian economy's dependence on oil and gas is viewed increasingly negatively.

Brussels falls five places to 15, more than any other city, with interviewees noting a substantial loss of confidence among developers in the current inflationary conditions, while political instability is contributing to a lengthening planning process.

Zurich's position is also down, from 14 to 17. One reason may be that external investment is becoming more expensive as the Swiss franc appreciates, a trend the government may be loath to discourage due to its dampening effect on inflation. Interviewees nonetheless note strong transport links, a thriving hinterland and a well-diversified economic structure.

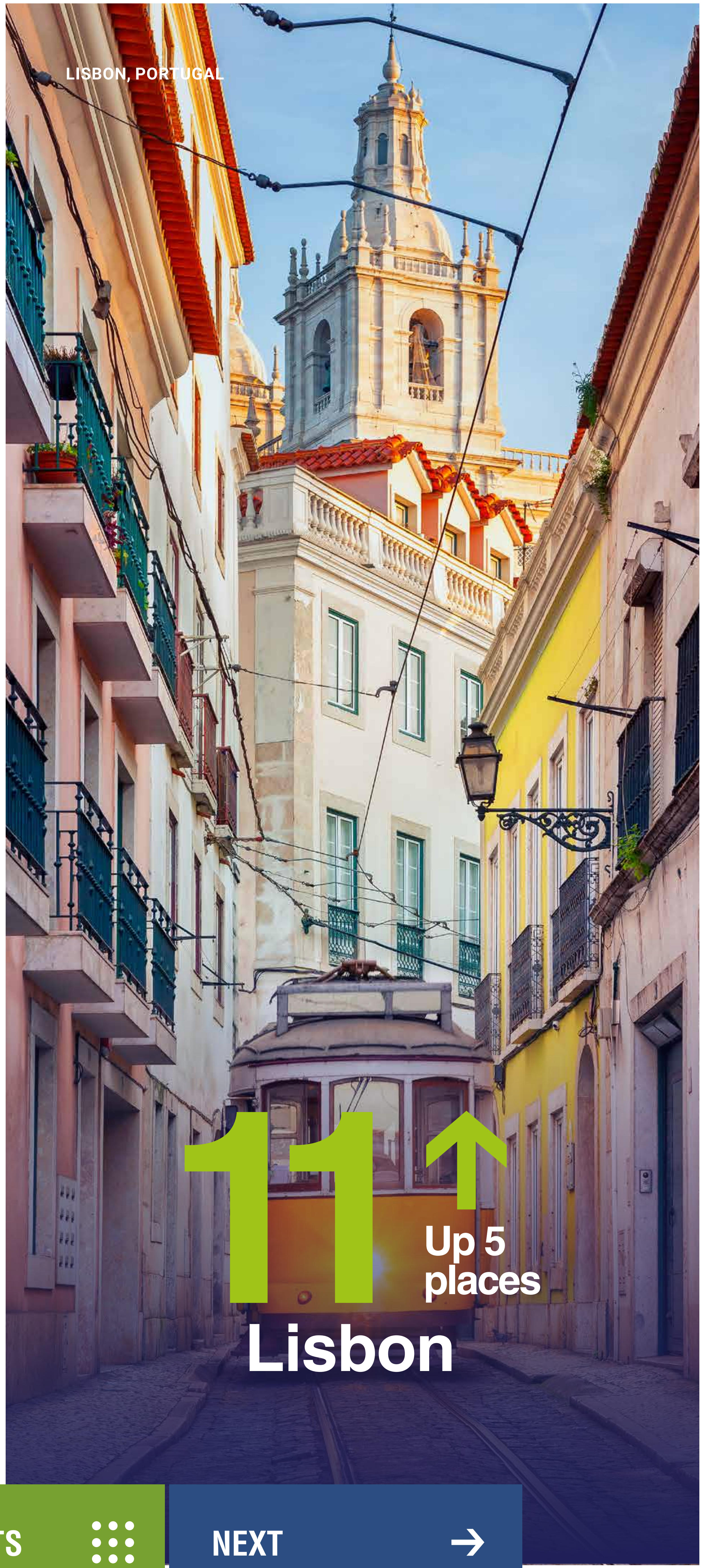
Among the provincial UK markets covered in the survey, Manchester ranks highest at 18, and is praised for its strong local governance, which has allied with good housing provision to support the city economy. One UK investor observes that Manchester is "notably different from London in terms of willingness for employees and offices to return to the city". A similar phenomenon is noted for Birmingham although the city is ranked lower, at 22, possibly due to its closeness to London and somewhat less international outlook. Edinburgh is lower still, at 26, with some suggestion that the political rhetoric around Scottish independence could lead to instability in the longer term.

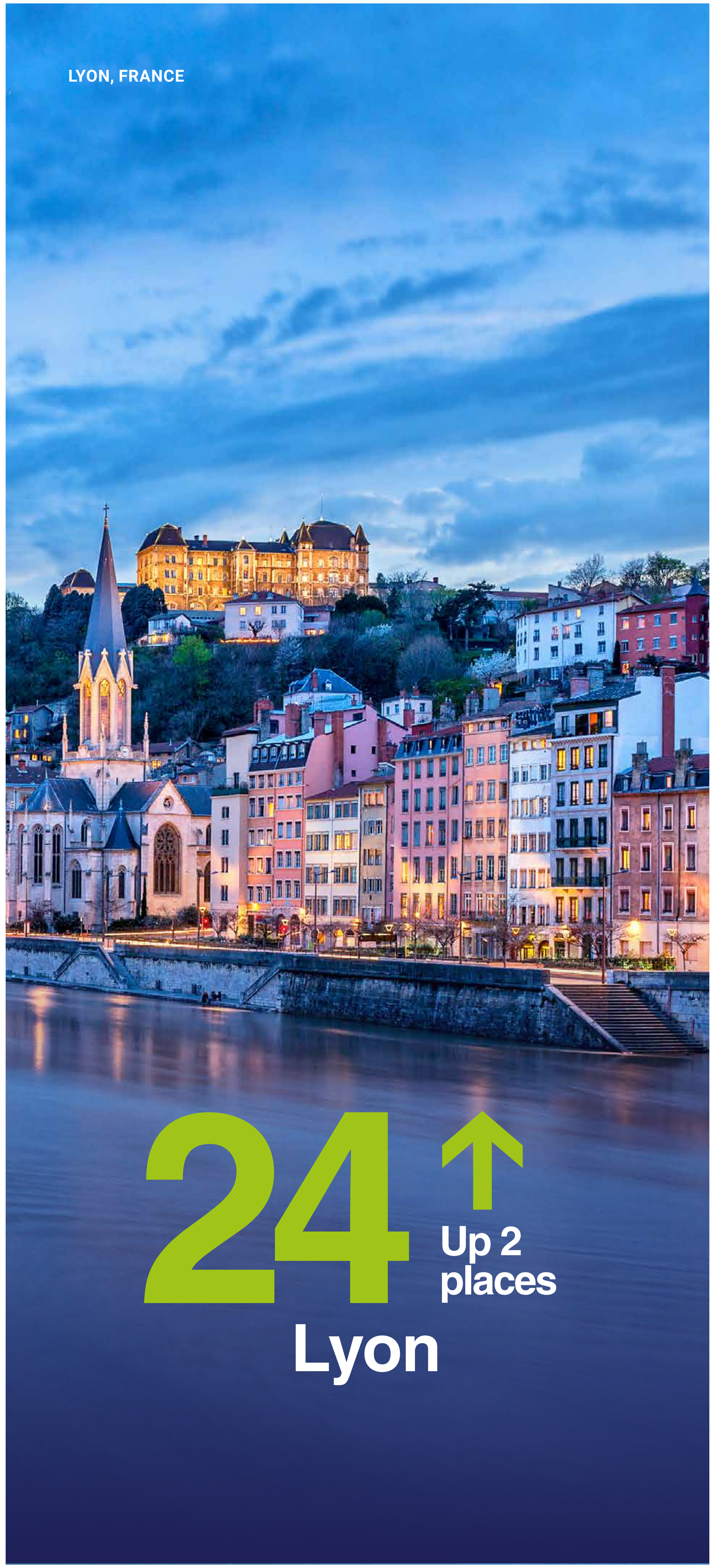
Although Rome is relatively lowly ranked at 21, some regard it as undervalued, with an improving environment and housing market. This is not only a combination of "how many people are likely to live there 10 years from now", one European developer says, "but also a matter of how the environment there is changing, which should attract talent for creating start-ups". Office prospects are also viewed positively, albeit off a relatively low base.

> “
> Things are going to get worse before they get better.

Lyon, meanwhile, rises two places to 24. A French-based international investor sees the city as “resilient, with a strong GDP trend, but it’s a relatively small market, with limited liquidity”.

Despite its ranking at 23 and the relatively small size of its investment market, Athens is well regarded by some interviewees for its rental and capital value prospects. A regional fund manager comments that “there’s still an under supply of prime stock because of the very protracted recession. Over the last 10 years there have been some developments in prime offices and retail, but opportunities are still there.” This contrasts with Istanbul, 29, where the same manager believes that “things are going to get worse before they get better”, adding: “You’re talking about triple-digit inflation, even though the economy keeps growing”.





CHAPTER 7

20 YEARS OF EMERGING TRENDS EUROPE

"In the old days, we did property, we owned property. We were remote from the real world as owners. I cannot believe how myopic we were. It was incredible, really, when you look back on it."

Pan-European investor

PARIS, FRANCE

20 years of *Emerging Trends Europe*

2004

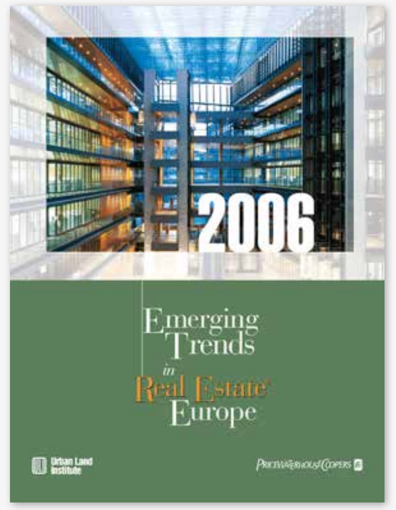
"We are building as we have done for the past 30 years," says one interviewee, "without questioning if this meets the requirements of a changing society."

2005

"Everyone is looking for income," says one interviewee as investors shift into multiple sectors, even niches like car parks and self-storage. At the same time: "The high street is dying."

2006

A vocal minority of investors warn of a market bubble that may soon burst. "We're having to take on more and more risk for less and less return," says one.



2007

Property is expected to outperform other asset classes in 2007 but says one interviewee: "If 12 o'clock is the top of the cycle, we are at five minutes to 12."

2008

Battered by the US subprime crisis, "fear is back" for Europe's property players. Says one: "Consumers are fine, tenants are fine, the countries are fine — the missing link is debt."

2009

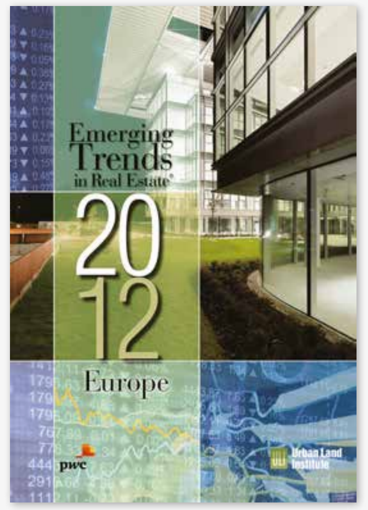
The global financial crisis has been "devastating" for Europe's property industry. "I would put it alongside the fall of Rome — though this time the barbarians were already inside the gates."

2010

Europe's economic recovery is weak and consumer spending restrained. Tenants want rent reductions; negotiations with bankers are "mentally gruelling." The key question, one investor asks: "Will there be tenant defaults?"

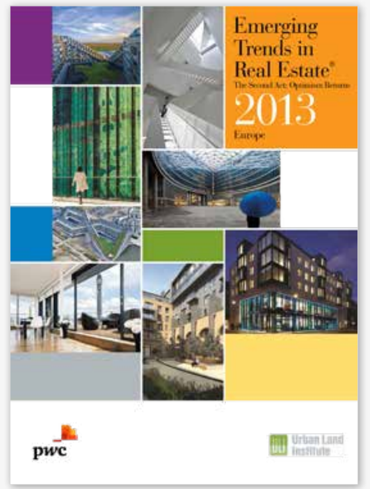
2011

In "austerity Europe", the lending market remains tough and the challenge lies in managing risk. "We need leaders with strategies, not acquisition teams with too much money," says one interviewee.



2012

The industry laments renewed liquidity issues, a gloomy economic outlook and possible breakup of the Eurozone. "Equity will not enter at current prices, yields and expected return," says one investor.



2013

After a five-year "Darwinian struggle", optimism returns. Global capital starts flowing into core property via the big investment managers while some specialists seek value-add opportunities from banks flipping distressed assets.

2014

As competition for prime assets intensifies, investors seek stable income from student housing, data centres and other alternatives. Green buildings, too, are seen now as part of "a consolidation of quality".

2015

Investors are veering between core and opportunistic assets, as reflected in the survey's top five cities: German stalwarts Berlin and Hamburg alongside the recovery plays of Dublin, Madrid and Athens.

2016

Industry players look beyond rent collection and consider property as a service: "Twenty years ago, we had tenants, now we have customers," says one. "In 20 years' time we'll have guests."

2017

Populism — especially Brexit — weighs heavily on real estate. Returns are scaled down and active asset management talked up. In this risk-off climate, Germany is regarded as a haven for capital.

2018

Technology becomes increasingly important to logistics' enduring success as well as the rise of co-working and "space as a service". Says one interviewee: "Collaboration between tenant and landlord will be more and more crucial."

2019

Core asset values are at record levels and in this late-cycle market industry players are starting to cherish "sustainable cash-flows" — increasingly from residential and alternatives — and adopt "develop-to-core" strategies.

2020

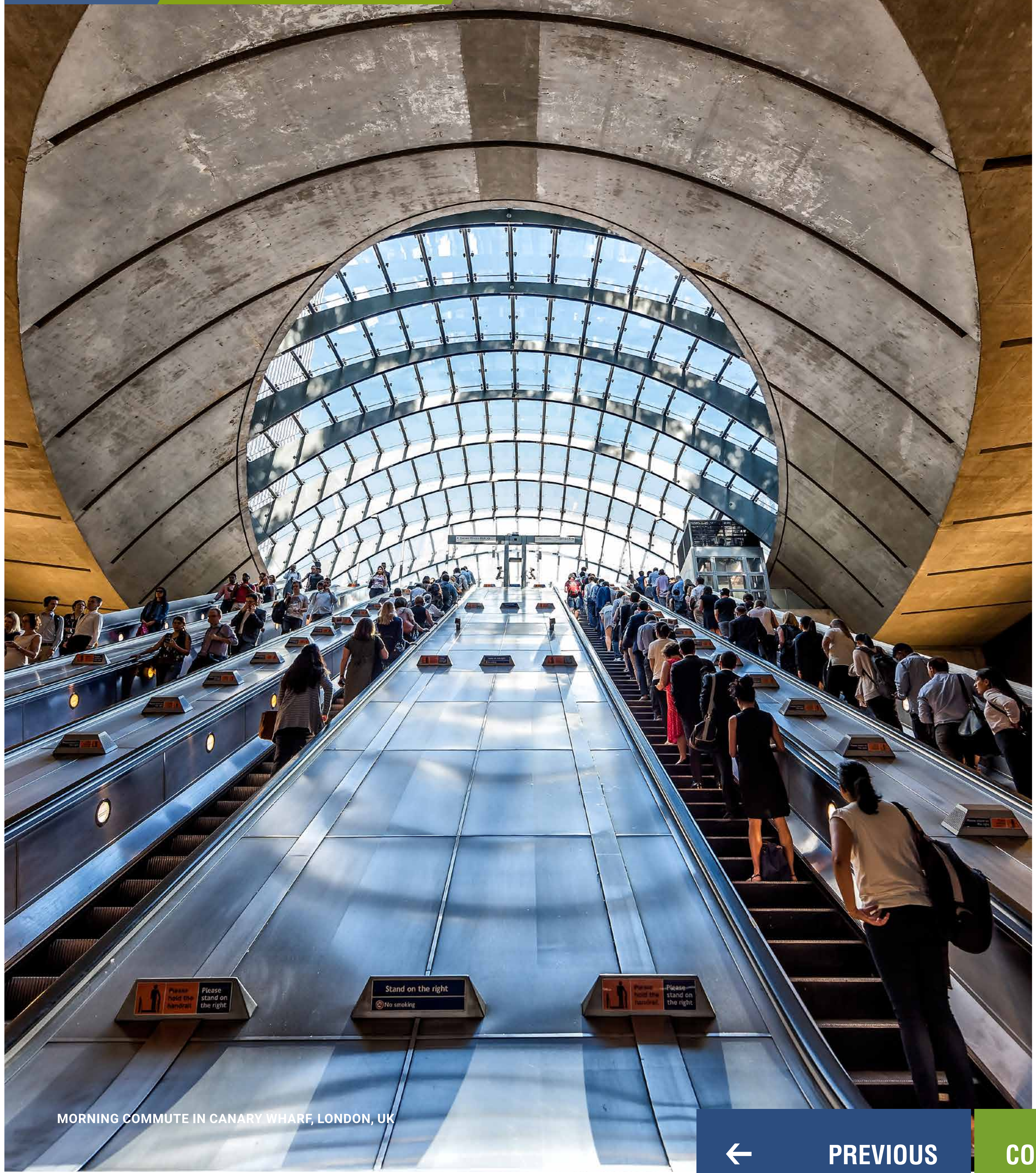
Property continues to outperform other asset classes, but there is caution given the darkening macroeconomic outlook. "Occupier decisions are taking a little longer than they were last year," says one interviewee.

2021

COVID-19 led to sharp recession in 2020 and the prospect of a fragile economic recovery in 2021. "Everything that was being disrupted is being disrupted at a much faster pace," says an investment manager.

2022

The industry adapts as the pandemic accelerates digitalisation, dispersed working and online shopping, while hugely reinforcing the ESG agenda and highlighting the need for greater emphasis on customer service, brand and reputation.



MORNING COMMUTE IN CANARY WHARF, LONDON, UK

The industry reflects and looks forward

***Emerging Trends Europe 2023* is the 20th edition of this annual report, which over the years has reflected profound changes in the way European real estate is used, financed, traded, developed and managed.**

To mark this anniversary, ULI and PwC have gathered some of the senior leaders who have witnessed these changes first-hand, as well as a younger generation of professionals who will be steering the real estate companies of the future. What follows are reflections on the key trends that have shaped the industry to date, and informed views on the trends that may emerge and define it over the coming 20 years.

Taking on board these insights while reviewing the back catalogue of *Emerging Trends Europe*, it is evident just how much real estate companies are changing the way they operate, "and way faster than anyone anticipated".

In the interviews for the 2004 report, no-one referred to megatrends. Yet over the course of 20 years, urbanisation, technological, demographic and climate change have come to dominate the narrative. Within a few years, the reporting of biodiversity footprints and targets is widely predicted to achieve the same level of scrutiny as climate resilience and carbon emissions today.

Yet those early editions of the report revealed how data was starting to revolutionise the industry through greater transparency, educating a wider audience of investors of the nuances between different sectors.

The use of such information, combined with prolonged low inflation and interest rates, led to a "Big Bang" in the investable universe and a fast-maturing, cross-border investment market. And alternative real estate, such as hotels, healthcare and student accommodation — downplayed as "quirky" assets as recently as 2007 — have become opportunities to invest through the ups and downs of economic cycles and serve a more diverse range of risk and return appetites.

The global financial crisis (GFC) changed the industry's direction yet again. The banks pulled back, and if they lent at all it was at modest loan-to-value ratios, a conservative approach that has not altered since. A new generation of lenders, in the form of non-listed debt funds, set up shop to serve the market with gearing across different slices of the capital stack. The alternative lenders will continue to innovate and influence the finance market.

Another legacy of the GFC was that capital allocation based on the expectation of yield compression, with no other value creation besides, looks anachronistic at best, risky at worst.

As interviewees look to the future, many see that a range of pressures — from the changing needs of occupiers, macroeconomic volatility, sustainability, technology — will radically alter the process of creating returns from bricks and mortar.

Real estate is transforming into a service industry as occupiers become customers with a range of needs and desires. Property companies, as the following pages explain, will be required to become more operational in nature, and broaden skill sets, to stay relevant.

Global capital markets will also reflect the rise of digital-savvy investors who will become a dominant voice as they seek to balance their long-term wealth against their impact on people and the planet. This is what interviewees define as "responsible capitalism" and will be part of a property company's DNA in the context of a world beset by inequality, housing crises and a desperate need for social infrastructure and resilient cities.

When it comes to the factors determining success in the next two decades, 94 percent of respondents to this year's survey stress the importance of running a socially and environmentally responsible business. The climate crisis will drive this further. It is one trend that has only gained in prominence and relevance across *Emerging Trends Europe's* 20-year history, uniting the past, present and future. Developing green buildings has grown from a side-line exercise promoted by the faithful few who felt — in the absence of proof — that they would eventually yield the most value, to an issue that no property company can now afford to ignore.

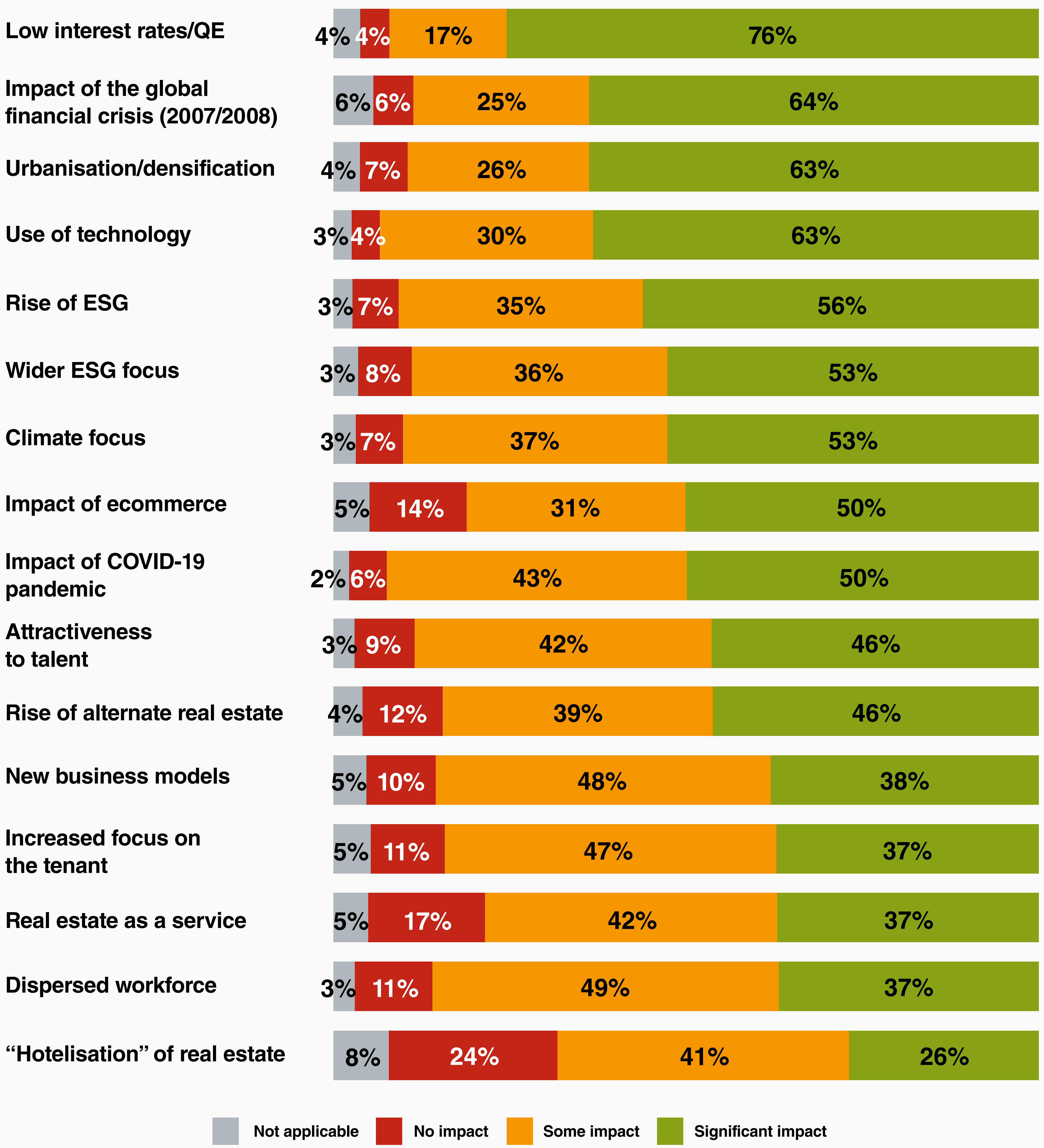
Today, the environmental impact of real estate is acknowledged by everyone, but a daunting, 20-year challenge nonetheless lies ahead for the industry. Putting this task at the heart of real estate businesses — providing carbon-neutral buildings, tackling embodied carbon and creating resilient places that make urban living more habitable and sustainable — is not simply a matter of corporate survival, it is a moral imperative.

Such work will require a collaborative effort on a scale never before seen. As one interviewee, envisaging the real estate industry of the future, says: "I hope that we finally have stopped building for eternity, and that we eventually start building with modules so that we don't have to tear down entire buildings and start again".

The extent to which acting in the interests of these wider concerns will dovetail neatly with pure economic benefit remains to be seen. But many hold the view that the best way to predict the future is to create it.

> "I hope that we finally have stopped building for eternity, and that we eventually start building with modules so that we don't have to tear down entire buildings and start again.

Figure 7-1 **Factors that have had the biggest impact on the real estate industry over the past 20 years**



Source: *Emerging Trends Europe survey 2023*

Capital markets

Over the last 20 years, real estate has emerged from the shadows and metamorphosed from an opaque industry to one that is integral to the financial markets.

A crucial starting point for this elevated status came in the early 2000s, when the availability of new indices gave investors a way to benchmark and track performance. MSCI (then IPD) established the first indices to measure the performance of institutional real estate. Launched in the UK in 2000, and then across Europe, it provided insight into the performance of assets in listed and unlisted portfolios.

By 2004, real estate was proving its worth. *Emerging Trends Europe* reported that an "abysmal three years of equity market performance" had sent investors to the asset class armed with the data showing direct property returns had beaten those of all major European stock markets. By 2005, "an overabundance of capital" sent core investors climbing up the risk curve to obtain assets.

At the same time, investors wanted to diversify their portfolios since many still only invested in direct real estate in their home markets. Those who had ventured into new territory in the 1970s and 1980s had found to their cost that it was not easy to invest directly cross border without local knowledge or an experienced team on the ground.

This led to the evolution of indirect and unlisted market with the launch of EPRA in 1999 and INREV in 2003, which aimed to increase transparency, professionalism, best practice and knowledge sharing.

The increasing professionalisation has allowed investors to view property as a "super sophisticated market". Today it is a fully-fledged, dependable asset class, providing institutional investors with an attractive risk-adjusted performance, diversification potential, stable income returns and inflation protection across the non-listed and listed sectors. "Real estate has shown it has much to deliver and has delivered, particularly since COVID, and especially food-anchored retail, logistics and core residential. There are fewer surprises now," reflects one industry player.

Real estate investment now offers myriad options for the investor. Partly this is down to specialisation within the capital stack. At one time, returns could be accessed from equity investment, while banks issued the debt. Now institutional investors are able to access returns through equity or debt. They can gain exposure to different levels of risk via core non-listed funds and, at the same time, aim for higher returns, perhaps through vehicles offering mezzanine finance, or low-risk debt via the corporate bond market.

ROME, ITALY

Investors can also structure their investments in a variety of ways: through joint ventures, separate account mandates or partnerships and place capital for the long or short term.

Non-listed funds have led to ever-larger real estate vehicles, managing amounts of capital in the multi-billions. New niche sectors — such as healthcare, life sciences and data centres — have risen in prominence and importance in recent years, as reflected in *Emerging Trends Europe's* sector rankings.

With this growth has come greater transparency as well as an increasingly global and diverse investment base, exerting a huge influence on what property companies do, not least in their integration of ESG issues in strategic decisions.

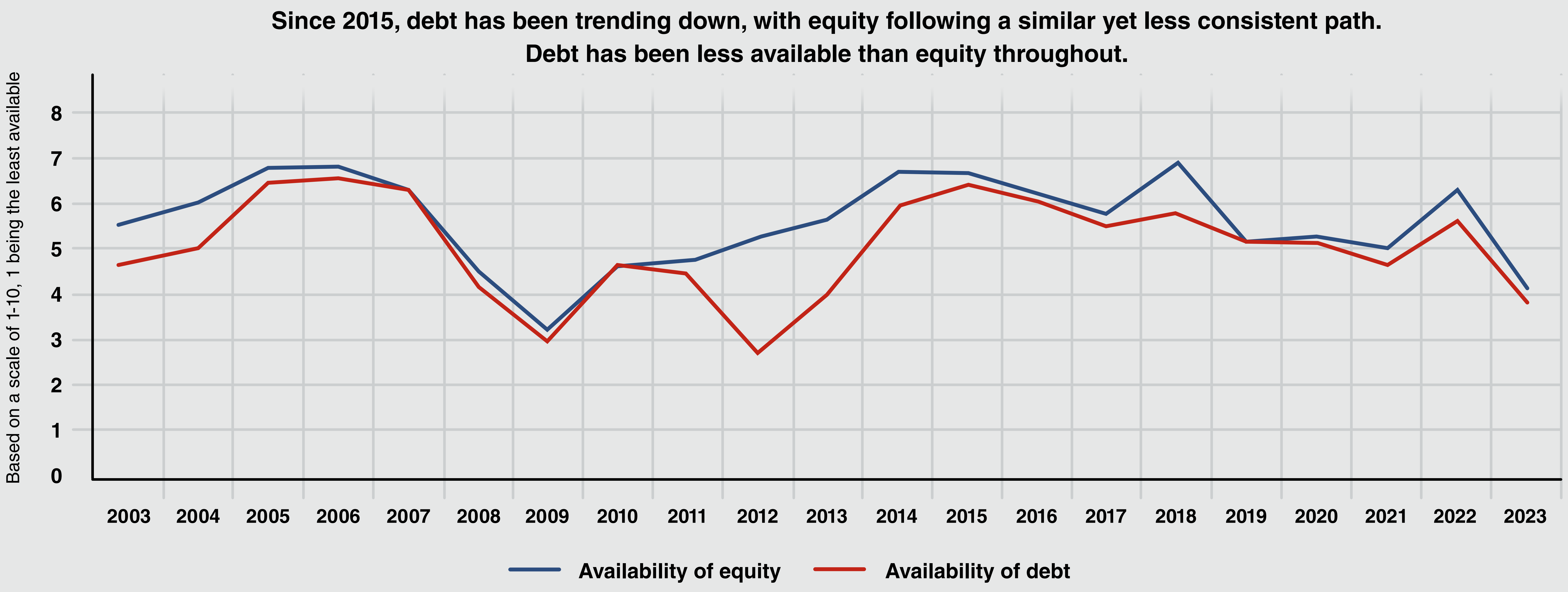
Since the GFC, the European listed real estate market has grown from €174 billion to €441 billion, according to Cohen and Steers, underpinned by increasing allocations from institutional investors.

Meanwhile the European non-listed real estate funds universe has expanded — from just 45 vehicles representing €16.9 billion of net asset value in 2001 to 536 vehicles representing €362 billion in 2022, according to INREV.

Industry leaders are confident that capital for real estate companies will continue to flow. Global assets under management (AUM) grew from $31 trillion in 2003 to more than $112 trillion in 2021. And in 2021, AUM grew at 12 percent — well above the annual average of 7 percent.

Figure 7-2 **Availability of equity and debt 2003-23**

Source: *Emerging Trends Europe survey 2023*



Institutional investors will hunt for scale for these increased allocations, as property companies become more operational to make inroads into new sectors where specialisation and management skills are imperative.

Increasing allocations to property will therefore drive a continuation of the high-profile corporate merger and acquisition activity and the trading of large platforms and portfolios that have featured in the market lately.

Financing innovation

In the years leading up to the GFC, investors were too often consumed with how they could use leverage to deliver better returns, and on the tax efficiency of the vehicle.

With the GFC came the painful lesson that while the financial structure of a property investment is important, it should be secondary to the strength of the underlying tenant and the quality of the bricks and mortar.

One consequence of this shift in mindset is the investors' new attitude to development. Before the GFC, development was seen as too risky and thus, every asset was bought turnkey; some fund structures, such as the Netherlands' FBI, for example, prohibited development altogether. Today, investors want to be involved as early as possible to influence the end product – develop to core – as one way of reducing risk.

ISTANBUL, TURKEY

The GFC led to other radical changes to the capital markets. As stricter regulations disincentivised the banks, property lost some big names as their first port of call for capital, including Eurohypo, Hypo Real Estate and Royal Bank of Scotland. "Debt has vanished," reported *Emerging Trends Europe* in 2009. Into the void came a new breed of alternative lenders as well as well-capitalised German banks and US investment banks. The overarching philosophy revolved around relationship lending and more conservative loan-to-value (LTV) ratios.

This approach to lending has not changed since then, and no one anticipates that it will. Nor does anyone expect a return to indefinite growth, with leverage driving heady asset values.

Indeed, the challenge for lenders of all shapes and sizes in the next few years will be the affordability of finance in a rising interest rate environment. In these conditions, the big banks will remain conservative, largely absent in anything other than the senior loan market.

Longer term, debt funds and other alternative lenders are expected to grow their share of lending as real estate credit allows institutional investors to benefit from attractive spreads and risk-adjusted returns — in effect, accessing property without having to change underlying strategies.

There is a widespread view among the industry leaders canvassed for this report that the debt funds have enabled property companies to manage capital requirements more efficiently. Moreover, they will provide the innovation required in real estate finance and, as some interviewees believe, adopt a more prominent role around the "manage-to-green" retrofit challenge.

"This has been a big story for real estate," says one interviewee. "The industry has a diversity of capital now. The debt funds are easy to deal with, faster, more aggressive and it's been healthy for the market because these are the lenders that will help drive change and innovation. Banks, which are slow to evolve, will follow their lead."

Disrupting capital flows

In 2008, *Emerging Trends Europe* observed that the globalisation of real estate continued apace. Opportunistic money was heading east "where the markets are lively and yields chunky". Interviewees had "joined in the gold rush" and cross-border investment in Europe would become a normal function of the market.

The free movement of real estate capital has been interrupted by several epic shocks over the past decade. In 2012, *Emerging Trends Europe* reported that economists were becoming increasingly concerned that a break-up of the Eurozone was likely. Four years later Brexit would shock the markets. More recently, Asian investors stopped buying European assets post pandemic because travel restrictions meant they could not physically view the property. Today, political populism and geopolitical strife are the disruptive forces.

All of this turbulence will inform how global capital is deployed in the future. Investment will become more thematic, shifting away from strategies based upon cities, countries or regions.

At the top of interviewees' list of disruptive forces influencing future portfolio construction are the known unknowns — more pandemics — but also the rise of China. "In 30 years' time the vast majority of the global middle class will be in China, not in the West. That will require a huge rebalancing of the global economy," says one. Another describes the prevailing US and China rivalry as "just one part of a new kind of world, which will move capital markets around with accelerated sub cycles". Others see the growing influence of China impacting the way European cities are designed, catering for Chinese consumer preferences.

The industry sees the wider capital markets becoming desynchronised, leading to greater variations in performance of equity and bond markets across countries. But synchronicity will persist in other ways. Interviewees report that technology — for instance, e-commerce in retail — means there is now greater international alignment in sectors. One interviewee reflects: "We are now marketing to specific audiences, not countries and cities, and this is especially true in leisure."

Another says of consumer trends: "Expectations have globalised, there is a more coherent audience."

Even then, some argue there will be layers of complexity as real estate companies will need to balance these consumer trends with locally focused concerns. Over the past 20 years, one interviewee says, globalisation has led to the convergence of office occupational trends, for instance. "But looking forward, with the developments that you see now, that could be going into reverse. If you have to become more regionally minded, that also has an impact on our industry. And there's the whole climate impact, which is actually one of the reasons for that change. If you have to find resources more locally and source energy more locally that will impact the organisation of our cities in a way that's different to the whole globalisation and organisation that we have [currently]."

> We are now marketing to specific audiences, not countries and cities, and this is especially true in leisure.

LA DEFENSE IN PARIS, FRANCE

On the path to net zero

Environment and sustainability strategies are key priorities for most industry leaders for 2023 — as they have been for some time — and climate risk is widely acknowledged as the biggest challenge facing real estate over the next 20 years. Yet it has been something of an effort to get to this point.

As recently as 2007, *Emerging Trends Europe* noted that when property professionals were surveyed about European sustainability legislation "a significant proportion knew little and cared less about the issue". Green buildings were dismissed as a "marketing gag".

A senior fund manager remembers those days well and recalls suggesting to his boss that they should start taking sustainability into account in their investment decisions. The response was hardly encouraging: "All right, as long as you don't go around hugging trees, and some of this is about investment returns."

The industry was already monitoring performance through the likes of BREEAM and LEED. Though important in making buildings more environmentally friendly some argue that such benchmarking led to an obsession with box-ticking, green labels.

But by 2008, the winds of change were blowing and environmental issues had "moved sharply up the agenda", according to *Emerging Trends Europe*. In that year a developer of sustainable buildings recalls meeting US politician Al Gore, who was promoting his documentary about climate change, *An Inconvenient Truth*.

It was a personal turning point, he says, which took place at the moment when the issue "went mainstream".

The global financial crisis (GFC) did little to derail the agenda, despite speculation that "mean not green" might prevail. By 2015 *Emerging Trends Europe* stated: "Sustainability is no longer an emerging trend: it has become a fact of real estate life." Today, an ESG professional charts the industry's journey: "In a 20-year time-frame, we went from CSR, to ESG, to climate adaptation and resilience."

Some interviewees believe it is too early for self-congratulation, however. As one urban strategist says: "If you look at how a lot of ESG funds affect the environment, there's not even a correlation. It's just hype."

At the same time, macro-economic headwinds threaten to obscure the climate crisis, at least temporarily. "Even state development banks in the Eurozone are making very opaque statements as to whether their duty is to invest in either fossil fuels or in the energy transition," one economist points out. "The same thing goes for some of the largest asset managers in the world, which are saying that they have a fiduciary duty. Yes, they have ESG, but now, it's about energy security."

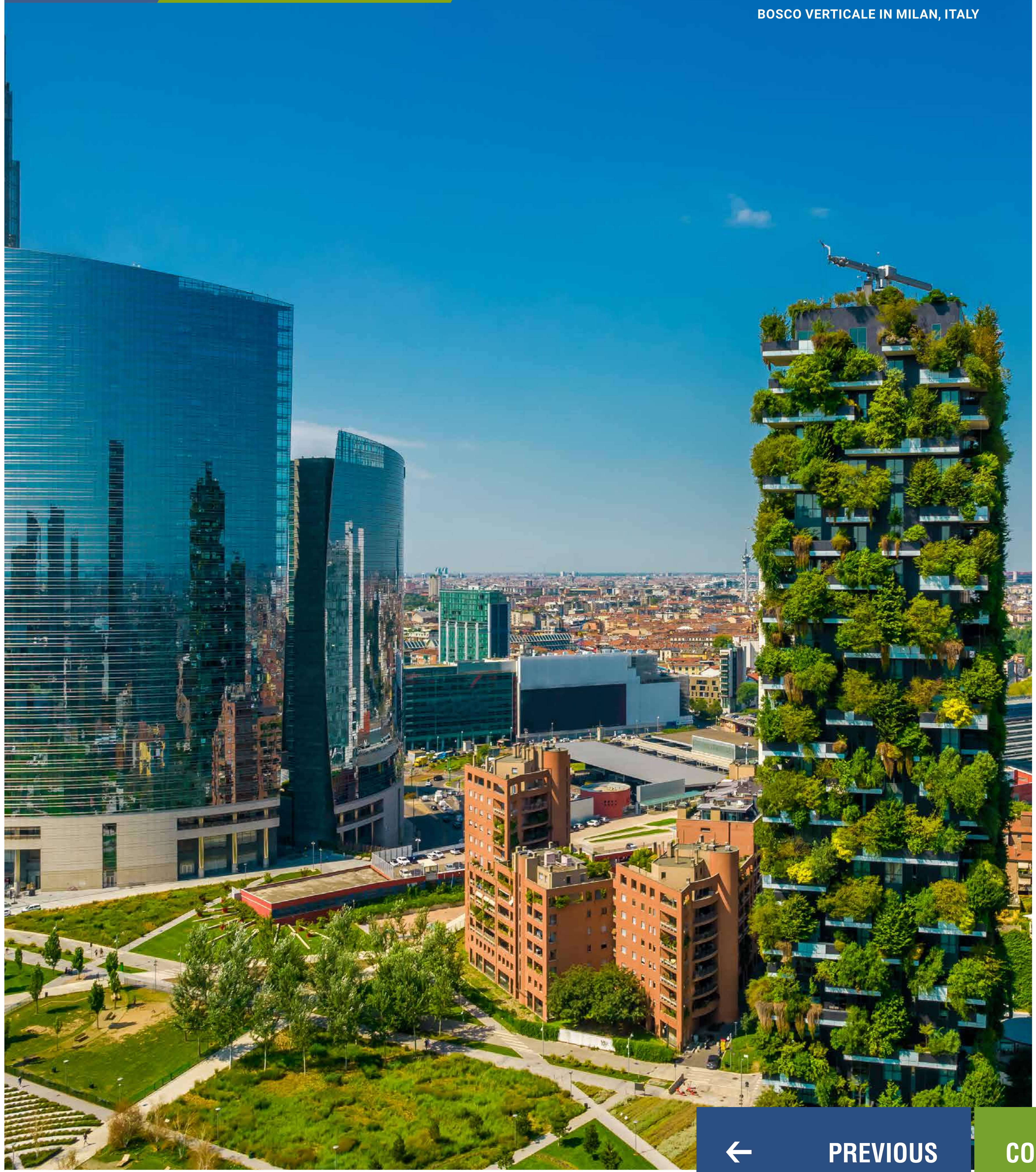
As with the effect of the GFC, that will be merely a bump in the road towards greater sustainability, according to one developer: "The European Green Deal is happening and there's no turning back on that anymore even with the Russian intervention now. The trend is completely clear where it's going."

Decarbonising real estate

It is now incontrovertible that the climate crisis will have a profound impact on the industry over the next 20 years. Real estate veterans specially convened for this report conclude that "the refurbishment of existing buildings is the greatest challenge the industry faces and will impact values". Likewise, a ULI Young Leaders panel expects "huge pressure for change", given that the built environment produces around 40 percent of carbon emissions.

Figure 7-3 **Expected catalysts of change in real estate over the coming 20 years**

Source: *Emerging Trends Europe survey 2023*



BOSCO VERTICALE IN MILAN, ITALY

"In Europe, there are €200 billion of non-ESG compliant assets that cannot find a single bid," claims a venture capital investor, adding that lower rents, higher cost of finance and higher cap rates could combine to produce a discount of 50 percent or more for low-rated buildings.

To meet the EU's climate objectives, real estate will need to achieve a 60 percent cut in greenhouse gas emissions by 2030 and fully decarbonise by 2050. As one senior investment manager points out, keeping pace with those targets is "the most material change the real estate industry can experience" because just 1.5 to 2 percent of the built environment is renovated annually.

While many new buildings demonstrate impressive environmental credentials, the challenge is broadening from emissions reduction in use to minimising embodied carbon, so the coming decades will see the industry forced to break the cycle of demolition and rebuilding. Today, governments already question the wisdom of new concrete and steel buildings — a difficult question for the industry that will not dissipate.

Interviewees see policy increasingly directing developers to repurpose. "It's going to get harder and harder and less and less appropriate to knock down buildings, so people are going to be looking at reusing what is already there," says a REIT CEO. "But also, new buildings will be constructed so that they are flexible and their use can change. And, if they are dismantled, the materials can be reused."

Greening the existing stock will require vast capital expenditure and will need to happen swiftly to meet climate goals.

Regulatory authorities will play a vital role in that process: "Creating benefits out of environmental policy must fall to regulation and governments to create standards. Then the private sector's role is to optimise performance within those standards."

Public authorities will also increasingly resort to taxes and incentives to achieve decarbonisation: "Most economists would say that a carbon tax is actually probably the most efficient way to fight climate change, because it's classical economics and you're incentivising behaviour," says one economist.

Though property professionals desperately want clarity in the "alphabet soup" of guidelines around ESG, they are starting to recognise the value of regulation here, which as one of the ULI's Young Leaders argues, "has a huge positive note to it which we might not appreciate enough yet". But to stay on top of regulation, investors will need to go far beyond what is required.

Renovating existing stock will present a practical challenge because many buildings designed and constructed over the past 30 years are of a low standard, argues an architect: "We are stuck with a legacy of poor and expeditious decisions made around cost, as opposed to around quality and longevity. There is a big lesson there for how we design and build in the future. We have got to look at what we can reuse, and then if we have to rebuild, we must do it so that we don't have the same problem again 40 years from now."

Technology embedded within smart buildings will control how they interact with the environment, playing a crucial role in supporting the sector's journey toward sustainability, says the COO of a global asset manager: "The building will be rich in data, rich in insight about itself, and it will self-heal, it will self-manage energy, waste, water, to deliver much more optimal ESG outcomes."

Where development is unavoidable, naturally grown building materials can minimise emissions, argues a green proptech entrepreneur. "Whether it is timber, cross-laminated timber, or hemp-based materials like hempcrete, they provide an amazing opportunity to build in a more efficient way." They do present challenges, however, as one ESG consultant warns: "Everyone is going to be looking at the fire qualities and the insurance implications."

Not only will real estate need to minimise emissions over the coming decades, it must also adapt to the effects of global warming that are already being felt, and which will inevitably worsen. "Water, heat and questions of resilience need to be at the heart of the conversation. They speak to what the new commercial models of the future are going to be," says a futurologist.

One architect believes the urban fabric will need to adapt: "It's going to change cities a lot, not just around clean energy, but also the permeable surfaces we create, the way we deal with water as a valuable asset, and the way our streets are overshadowed, which is regarded as a good thing in more extreme climates like India, or the Middle East."

"The best adaptation is relocation. You shouldn't be making 50-year investments in places that only have 10 years left to survive," advises a US-based climate analyst. "Europe certainly has a more sustainable trajectory than much of the United States. Even with a large population, there's still plenty of liveable geography. But climate impacts will nonetheless exert an ever-greater influence on how locations are assessed and on individual property values."

With that in mind, climate modelling, which shows how assets will perform against extreme weather events at points in the future, is starting to be taken seriously by the major property players. Many institutional managers already incorporate physical risk in their due diligence and portfolio assessment albeit there is little consistency of approach or measurement. Once there is alignment across the industry, climate modelling is set to become an integral part of the valuation process over the coming years.

Yet at the same time that climate change is accelerating and most negatively impacting the people of the southern hemisphere, the northern hemisphere, which is more liveable and resilient to climate effects, is aging and depopulating, according to this analyst. "If we simply allow supply to meet demand, we will alleviate labour shortages, replenish our populations in liveable geographies, and also reinforce or buttress our property markets. Demographics and climate change are truly foundational for our understanding of the future of real estate asset prices."

Though climate risk remains at the heart of ESG programmes, biodiversity is also coming to the fore as a consideration. The World Economic Forum estimates that transitioning global infrastructure and the built environment towards nature-positive designs could generate over $3 trillion in additional annual revenues and create 117 million new jobs by 2030.

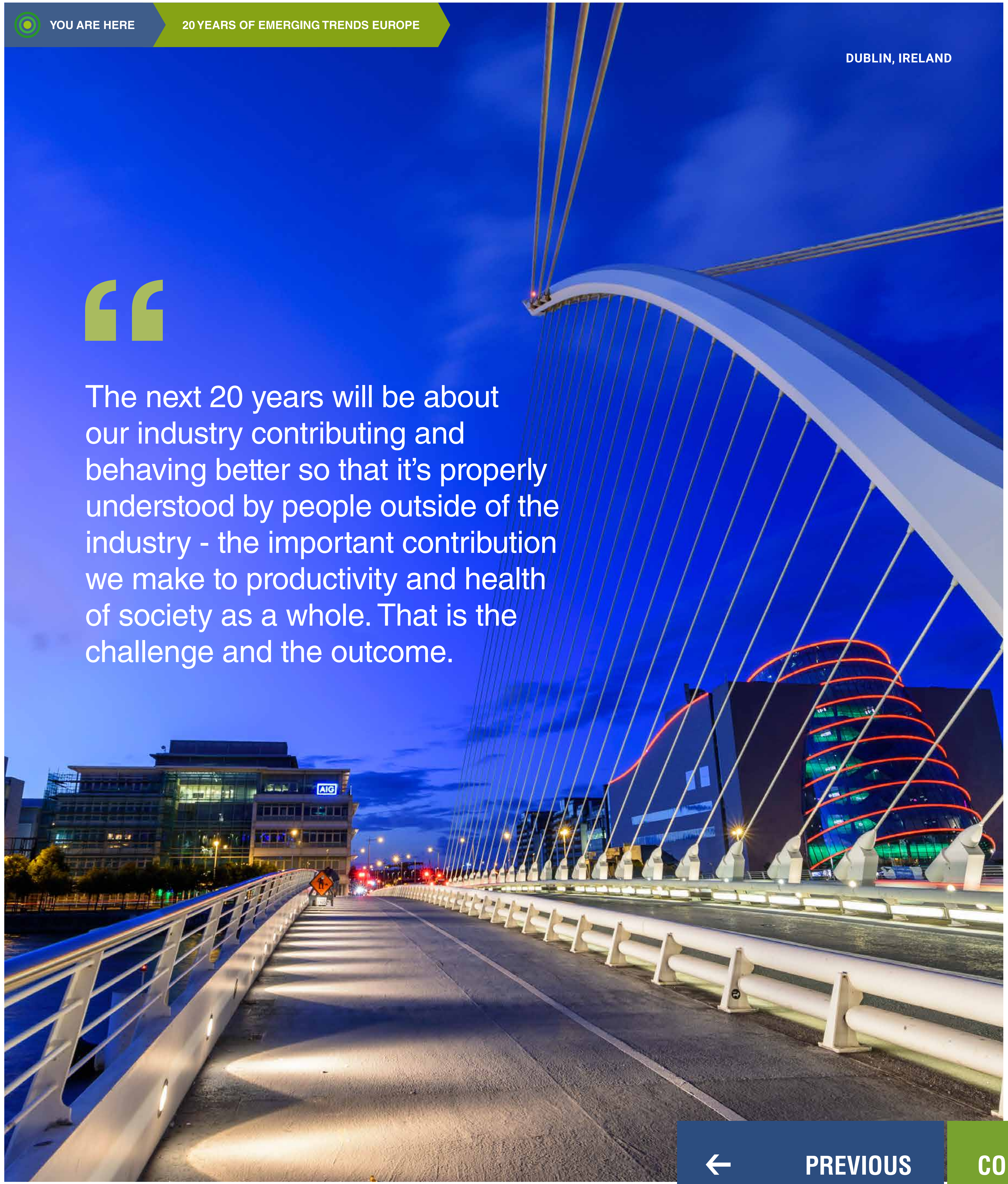
Already cutting-edge developers are monitoring biodiversity within their projects with the aim of creating more diverse, balanced and self-sustaining ecosystems.

As one entrepreneur explains, the work here involves the creation of communities based on the "concept of regenerative resiliency," of clean water, renewable energy, high-yield organic food production, and waste resource management, connected to Passivhaus home-building principles. The same approach can be applied to the retrofitting of existing urban landscapes.

It is possible to capture water, harvest a certain amount of food and create green spaces that can influence microclimates. Owners can then assess their existing portfolios and identify opportunities for rooftop, balcony or atrium greenhouses, as well as energy generation.

As this entrepreneur concludes: "We live on a very fragile planet, and one of the biggest offending industries is the built environment, but she can be restored if we take the right steps precipitously to do that."

ONE CANADA SQUARE IN LONDON, UK



Taking on greater responsibility

The climate crisis will be a huge driver in the shift towards a more responsible real estate industry, and it will become intrinsic to fiduciary duty, according to interviewees across the spectrum of experience.

“The next 20 years will be about our industry contributing and behaving better so that it’s properly understood by people outside of the industry - the important contribution we make to productivity and health of society as a whole. That is the challenge and the outcome,” says one senior property professional.

But real estate’s version of responsible capitalism is not just about carbon reduction. Interviewees frequently refer to the “mounting pressure” on the industry to ensure people have access to decent quality, affordable housing.

This theme reflects growing concern over how property companies “do the right thing” by taking the social impact of their activities into consideration and embracing new categories of stakeholders — impact investing.

The social upheaval brought about by COVID-19 has certainly provided impetus to the growth of impact investing. “Tenants and occupiers want us to act,” said one pension fund investor in the 2021 edition of *Emerging Trends Europe*.

“In the past, we didn’t need to listen but the sector will be challenged by society to do more now.”

Another interviewee that year lamented the lack of liquidity and quality in social infrastructure across Europe, adding: “The pandemic has shown that there are elements of our social infrastructure that fundamentally don’t work and need investment, healthcare being the most obvious.”

Today, the interviewees for this report refer to loneliness, growing inequality and ageing populations as among the societal problems that real estate companies can — and should — help alleviate.

Over the next two decades, therefore, expect innovation from those signed-up to this new breed of capitalism, which one interviewee defines as based on “people, planet and profit”.

Stakeholder-anchored governance models could be one version of this, while looking at strategies from the standpoint of wellbeing and society will feature regularly in board meetings.

“All of those perspectives need to be heard,” says one interviewee, whose firm has legally committed to provide quality affordable housing as part of its corporate mission. As this industry leader suggests: “Housing is a human right.”

Thinking long term

Inevitably the industry will move towards longer-term management and oversight of projects: "It is really important to talk about social inclusion and to define what success means. Otherwise, you can design a neighbourhood, decide [for yourselves] it is a great place and then walk away."

The number of those adopting such ideas may be relatively low in 2023, but interviewees predict this will grow, particularly as the public sector balance sheet becomes increasingly stretched, and "people's faith in politicians erodes".

Thus, we will see property companies increasingly involved in providing social infrastructure, greater amounts of public realm, healthcare and community spaces to ensure quality of life in ever-crowded towns and cities. "We must work with public authorities, with government, the utility companies. You can't achieve placemaking alone." One interviewee hopes, however, that city authorities will also become partnership-orientated: "There are cities in Europe where they just hang onto the rule book, they are not forward-thinking. That will have to evolve."

Thinking long term is mooted by many as vital to this more inclusive approach to investment, and naturally it will affect financial returns. One veteran investor says: "External events force you to think about the short term. What we need to think about is our longer-term impact on the built environment. We must force ourselves to think this way, to reposition and rebalance."

Industry leaders acknowledge it is getting "harder and harder" to have a short-term investment horizon if you want to deliver social good. "There are things you can do in a three-year time frame — buy it, improve it and give it back to the market in better shape. But how you do it really matters. Low cost of capital gives you more freedom."

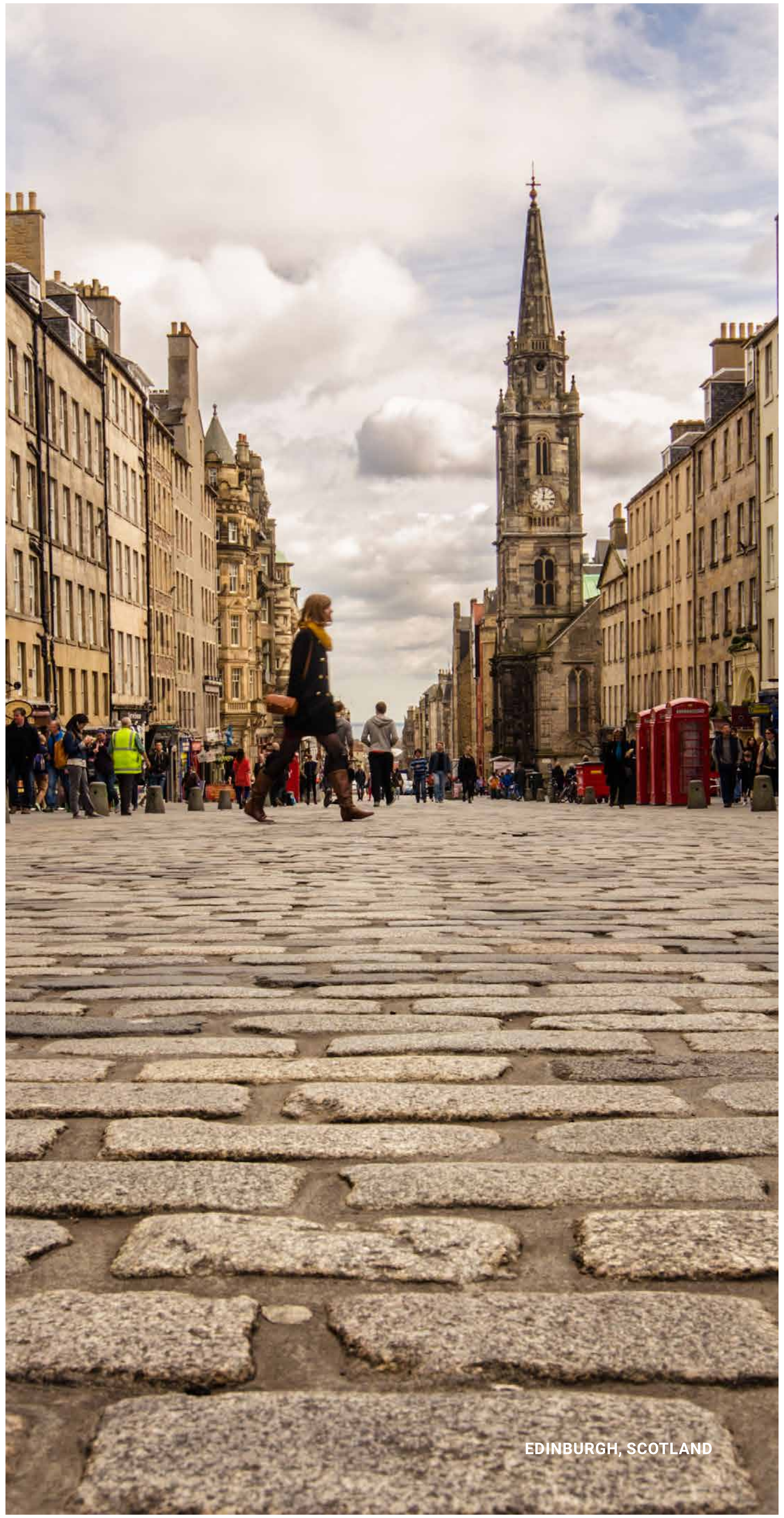
Another says: "When you speak to the premium investors, they say we will have to accept there's going to be less of a return because the reputational risk necessary to make that higher return isn't worth the aggravation that is needed to create that return, especially if you're also saying you want to behave in a way that is better for society. You already see private equity houses being more muted in their return expectations. Even Blackstone is sweeping up more long-term capital – that's interesting."

Interviewees investing long-dated pension money are seen as the property investors that will make headway in this respect, with the ability to partner their "patient capital" with the public sector to create better social outcomes. "The single biggest issue for us to work on is ensuring there is a productive and impactful partnership between the private and the public sectors," says one.

In principle, the recipe for success in regeneration in a post-pandemic world will be "less competition, more leadership and collaboration".

"It's early days. But it's perfectly possible that as we roll forward in the next 20 years it'll become obligatory and normal practice to behave with an inclusive version of capitalism," one industry player reflects, adding: "Maybe that means short-term private equity players and investor-traders will get less and less credibility for what they do."

> "External events force you to think about the short term. What we need to think about is our longer-term impact on the built environment. We must force ourselves to think this way, to reposition and rebalance.



EDINBURGH, SCOTLAND

Customer service

A key question for property firms over the next two decades will be whether they base their business models on physical real estate or embrace the overall concept of providing space — and a service — designed around needs of the occupiers they want to attract.

The property professionals interviewed for this report suggest that real estate companies will have to think much harder about a building's purpose as well as the objectives of the organisation and people who will use the space.

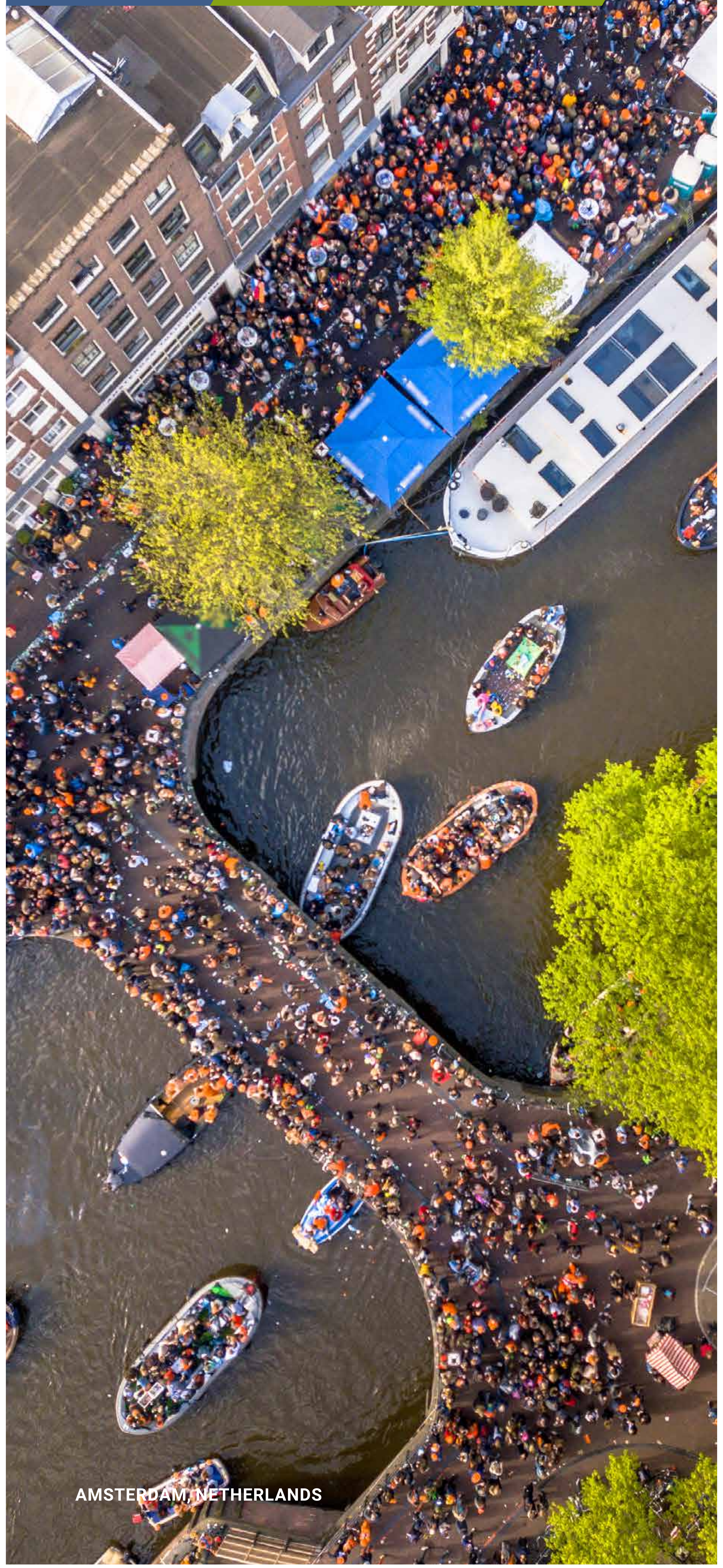
"Fast forward 20 years," says one interviewee, "and what we will see is that the built environment will be human-centric across the board: it will be in everything we do, the way we invest money, the way we develop, the way we build and manage."

Over the past 20 years, *Emerging Trends Europe* has charted a gradual shift in focus from landlords to tenants and occupiers — and more recently, customers. "There has been that pivot," says one senior consultant today, "so that consumers are at the heart of all conversations."

This change in approach has been seen most clearly in the fallout from the pandemic, which triggered an existential crisis in offices and an acceptance of hybrid working. Leasing decisions now prioritise high-quality spaces that help occupiers to organise staff and collaborate more effectively. "Companies will be very focused on the purpose of space," one interviewee says. "Their employees want the office to serve a real purpose, not just offer what can be done at home."

In retail, that sense of purpose will be about experience and functionality — offering retailers efficiencies that help supply consumers with their e-commerce goods. Despite the current headwinds, interviewees are confident of the customer's desire to carry on visiting shops. "Look at Amazon," says another industry player, "its incredible growth trajectory has now plateaued. It is hard to say why but there remains a place for bricks and mortar to offer retailers cheaper ways to deliver merchandise." As cost pressures intensify, the argument runs, retailers will increasingly see stores as opportunities to offer click and collect and ship from the store, removing the need for special warehouse pickers: "All of a sudden the story of bricks and mortar is more profitable."

ST. STEPHEN'S BASILICA IN BUDAPEST, HUNGARY



AMSTERDAM, NETHERLANDS

Working with customers

The successful property businesses will be those that work closely with their customers, to ensure that the real estate they occupy reflects their corporate culture.

As occupiers demand flexibility in their relationship with real estate it will place pressure on the longevity and nature of a property's income stream. As one says: "The next 10 years are going to be about reinventing leases."

In this respect, the industry will need to focus "on value and not just valuation". While valuation is driven principally by rents and yields and then adjusted for a wide range of factors, this is only helpful in the short term. Increasingly, interviewees argue, the more relevant issue is whether the occupier can create genuine long-term value for its business through the activity that takes place in its building. If so, then there will be demand for that space, rents will rise and investors will want to own the building. "This is what drives value. This will mean that landlords will become much more involved in ensuring that the occupant can create value by keeping the space appropriate, up to date and conducive to the relevant activity. While this may mean more and more frequent capex, less income certainty and more intensive management it will also create real value."

Space, therefore, becomes a service, and successful real estate will be presented as such, "not by an owner but an operator, investor, developer, manager and creator of services all in one". Interviewees predict that over two decades these changes will have a "tremendous impact on valuation" as new locations and building structures emerge and match the need for flexible space and leasing options.

The interviewees developing mixed-use schemes today are already registering these shifts, as schemes that also contain neighbourhoods and public realm are proving much more complex to manage. As one developer of a major European regeneration project observes: "In the beginning we started managing buildings but after a while we realised that creating the value of the place was not about managing the buildings but the entire neighbourhood. This has been the biggest management change, and we are launching digital platforms to help with it."

As this developer says, new systems have helped increase footfall in the area, with events attracting thousands of people. "That platform means we can now introduce, for the first time, footfall rent in the city. As the flow of people goes up, so does the rent, as more people are passing by the retail units. We are therefore managing the place as a cultural platform, and we are collecting lots of data. Through this we can improve what we are doing because data can lead to action. That is going to the next level in the future."

But there will be vertical integration within property companies, too, which will bring functions they previously outsourced — such as property management — in-house to drive efficiency and provide a more streamlined customer experience. Property companies will also broaden their business models to provide design, development, management and operational services. This trend will be especially relevant to healthcare, senior living and residential.

Interviewees know that companies will be required to be operational in nature as the traditional property sectors are replaced with assets that are more multi-functional as well as those that address societal need, such as healthcare facilities. But further ahead there could be new kinds of innovation needed, as, for example, urban farms become imperative for food security. "The best companies will be those that are operational," says one. "In the old days, it was about long-term safe, secure income protected by an institutional lease. Now it's about being close to the operational activity in any asset."

> "In the old days, it was about long-term safe, secure income protected by an institutional lease. Now it's about being close to the operational activity in any asset.

YOUNG WOMAN WORKING ON LAPTOP BESIDE LAKE IN ITALY

Winning hearts and minds

Customers want business with "heart," and technology has already increased transparency over whether a company's actions echo their values, particularly around issues such as carbon impact. But property owners must also consider the "WeWork factor" and be mindful of image and brand. "Reputation and approach make a massive difference," observes one property player. "People don't like faceless companies. We're moving towards that more."

In 2017, *Emerging Trends Europe* reported that WeWork had "grabbed a new marketplace." "They don't have tenants, they have members. It will become a bigger proportion of the market, maybe 10 percent in five years," predicted one interviewee. Five years earlier, *Emerging Trends Europe* declared that the most active occupiers in office building design would pay greater heed to the need to inspire creativity. "For firms like Google, they don't just want a box, they want an environment."

In retail and leisure, consumers' tolerance of mediocre places will be lower: "People are time-squeezed, they are less likely to go to a good but flawed place. People are getting more methodical at making choices. That is what the internet teaches us to do."

Interviewees say the internet has also enabled shoppers to coalesce around entire movements, influencing trends in the occupier market. Such a phenomenon is evident in China today as young buyers are prioritising products "Made in China." The *guochco* (national tide) trend has sprung out of national culture of confidence and pride and has helped homegrown brands to expand their market share.

Digital connections

As industry leaders acknowledge, the development of broadband had been one of the major milestones for society in the past 20 years, enabling people to connect the place of work and shopping from where they live. This will continue to shape real estate, with hybrid working influencing the way residential is designed as one example: "Is a 30-square-metre flat appropriate for someone working from home? We need to rethink distribution of office space versus residential space in the city."

Real estate will be required to emulate other industries and demonstrate a better understanding of the customer than they have shown to date.

Technology – in the form of smart phone apps, mobile tracking technology, for instance – will help master this challenge by harvesting the data that is imperative to improving, and maintaining, a pleasant environment. Smart building technology and the internet of things will help make those environments more operationally efficient, not least in terms of energy usage.

The creation of value here will depend partly on connecting the digital and virtual with the physical environment to meet customers' changing needs. Everything is becoming mixed-use, or as one industry player puts it: "Designated space for one purpose is completely outdated; technology has allowed buildings to pivot around several uses. Every space needs to work hard."

Another interviewee suggests that industry leaders will need to invest more time in understanding “not only human psychology, but the psychology of society, the quality of communities, of families. Society has become very complex, and its needs are changing; there are more single parents, for instance. If we understand those changes, then we’ll end up designing better environments.”

As the industry moves away from the “extraordinarily outdated notion” of space dedicated to one use, the markets will expect major investment in smart building technology to enable data management and create “digital interfaces” connecting a property to the customer. The industry will need more data than ever. Or to put it another way, warns a real estate veteran: “Performance risk will be about the absence of data.”

In the future, buildings and the customer will be connected by the internet of things, and technology will decide on what’s needed to meet the demands of the user, driving efficiency and giving investors greater transparency. One predicts that if big tech companies delved into the real estate industry, they would have an impact, especially as no one business has a large market share.

At the moment, there is no technological standard for buildings, no operating system, but “a shared platform everyone will use … owned by Google or Microsoft” could emerge.

Diversity drives performance

Perhaps the greatest change to a company’s DNA in the future will be a broadening of experiences and greater equality. Though real estate has a long way to go, industry leaders recognise that companies will need to move away from the dominance of “male, pale and stale” boards and instead embrace greater diversity and increased skill sets.

One senior player argues that the “increasing professionalisation” of the industry has narrowed the type of individuals running property companies because the emphasis has been on efficiency. “The requirements for leadership in the sector have changed, more entrepreneurship is needed to address unprecedented changes.”

The idea that diversity is vital for success is a narrative already taking root, and many are optimistic that the groundwork being laid today will reap rewards by *Emerging Trends Europe* 2043: “The companies disrupting the sector are those companies which are moving faster than the more traditional culture allows.”

To support this and the increased consumerisation of real estate, property companies will be required to go outside their traditional skill sets to hire a wide range of people: engineers, scientists, environmental specialists, customer service specialists, placemaking experts, those with architectural backgrounds.

Says one interviewee: “The skillsets we need to be good at real estate going forward will be very different as we come to understand how intrinsic buildings are to business productivity, the competition for talent, to people’s health and well-being.”

Or as another industry leader puts it, a wider skill set is vital “if we are going to start treating people like real customers”.

“

Not only human psychology, but the psychology of society, the quality of communities, of families. Society has become very complex, and its needs are changing; there are more single parents, for instance. If we understand those changes, then we’ll end up designing better environments.

DUBLIN, IRELAND

Real estate as a product

Over 20 years, real estate has expanded far beyond the realm of office, retail and industrial into a hugely diverse menu of investable assets.

The next two decades will be much more about just how the industry oversees a blurring of the distinctions between the many and varied property types.

As industry leaders agree, advancing technology and changing consumer habits have already helped boundaries fall away between traditional sectors. “We are starting to enter a world where users are agnostic to asset class. They can use it like retail, offices or industrial and logistics if they want,” says a venture capitalist.

Such change inevitably leads to complex challenges around valuation and underwriting as well as the need for a far deeper analysis of risk and return. Yet the move away from single use real estate is seen by some as crucial to ensuring long-term sustainability. “Blended buildings really matter because space that sits empty and underutilised is hugely wasteful on every level, whether it is climate or cost,” argues an industry futurologist.

Figure 7-4 **Rankings of sectors' investment prospects over selected years**

Source: *Emerging Trends Europe survey 2023*

2004	2008	2010	2016	2020	2023
1. Shopping Centres	1. City Centre Shopping Centres	1. City Centre Offices	1. Retirement/Assisted Living	1. Retirement/Assisted Living	1. New Energy Infrastructure
2. Residential	2. Central City Offices	2. Apartment Residential (Rented)	2.= Flexible/Serviced Offices & Co-working	2. Logistics Facilities	2. Life Sciences
3.= High Street Shops	3. Hotels	3. High Street Shops	2.= Healthcare	3. Co-living	3. Data Centres
3.= Industrial/Warehouse	4. Shopping Centre	4. City Centre Shopping Centres	4. High Street Shops	4. Student Housing	4. Self-Storage Facilities
5. Retail Parks	5.= High Street Shops	5. Shopping Centres	5. Logistics Facilities	5. Healthcare	5. Retirement/Assisted Living
6. Central City Offices	5.= Industrial/Warehouse	6. Retail	6. Private Rented Residential	6. Self-Storage facilities	6. Healthcare
7. Manufacturing	7.= Retail Parks	7. Mixed Used Property	7. Student Housing	7. Private Rented Residential	7.= Logistics Facilities
8. Surburban Offices	7.= Housebuilding for Sale	8. Retail Parks	8. Hotels	8. Data Centres	7.= Affordable Housing
	9. Surburban Offices	9. Residential	9. City Centre Shopping Centres	9. Affordable Housing	7.= Social Housing
	10. Manufacturing	10. Office	10. Housebuilding for Sale	10. Flexible/Serviced Offices & Co-working	10. Private Rented Residential
		11. Industrial/Warehouse	11. Serviced Apartments	11. Serviced Apartments	11. Student Housing
		12. Hotels	12. Data Centres	12.= Hotels	12. Leisure Hotels
		13. Manufacturing	13. Central City Offices	12.= Industrial/Warehouse	13. Co-living
		14. Suburban Offices	14. Self-Storage Facilities	14. Science Parks	14. Industrial/Warehouse
			15. Industrial/Warehouse	15.= Housebuilding for Sale	15. Serviced Apartments
			16. Parking	15.= Central City Offices	16. Flexible/Serviced Offices and Co-working
			17. Social Housing	17. Social Housing	17. Leisure
			18. Surburban Office	18. Leisure	18. Housebuilding for Sale
			19. Business Parks	19. Parking	19. Central City Offices
				20. Business Parks	20. Retail Parks
				21. Suburban Offices	21. Parking
				22. High Street Shops	22. Business Hotels
				23. Retail Parks	23. Business Parks
				24. City Centre Shopping Centres	24. High Street Shops
				25. Out of Town Shopping Centres/Retail Destinations	25. City Centre Shopping Centres
					26. Out of Town Shopping Centres/Retail Destinations
					27. Suburban Offices

Emerging Trends Europe has analysed a burgeoning number of sectors over the past two decades, from just eight in 2004 to 27 in 2023. This is driven by increased diversity in housing and growing investor interest in alternative assets, which have been the top-ranking sectors over the past five years.

LEGO STORE IN LONDON, UK

This view of real estate contrasts sharply with the “asset allocators” of 20 years ago, who invariably ended up with 50 percent in retail, 30 percent in offices, 20 percent industrial. “That’s all we did because that’s where you could get long institutional leases,” recalls one senior institutional asset manager. “I’m astonished how myopic we were.”

As early as 2006, however, *Emerging Trends Europe* highlighted “a huge array of investors” interested in gaining exposure to such new areas as nursing homes, retirement communities, student housing, self-storage, car parking facilities, pubs, recreational facilities, spas, resorts, entertainment complexes, condo-hotels, schools, hospitals, airports.

Diversification intensified following the GFC as interest rates stayed low and income-seeking investors were impelled to engage with a wider range of asset types to find a home for their capital. Interviewees recall an “industry-wide” move towards alternative, or operational, real estate. And in their search for deals and yield in an increasingly liquid market, investors lost their fear of specialist management. The idea of property as a service has gained traction ever since.

Meanwhile, real estate has gradually morphed into “real assets” as the risks and rewards of infrastructure investing have become better understood. “Until 15 years ago infrastructure wasn’t really an established asset class. Infrastructure investments in the early days were more private equity-like, higher on the risk curve. Today, we have more clarity about which investments have a distinct infrastructure profile, and what is more private equity or real estate-like,” says the head of real assets for a pension fund.

For good measure, “social infrastructure” has been added to the investing mix. Governments seeking private sector capital to help deliver health, education and social care facilities have found willing partners in real estate investors keen to secure low-risk, stable income streams insulated from market cycles.

Inevitably, the relative appeal of some sectors has declined over 20 years, while others are in the ascendancy. The most striking rise and fall over the period is that of logistics and retail, which caught out many property professionals in the early editions of *Emerging Trends Europe*. From 2004 to 2007, a blinkered real estate industry repeatedly identified shopping centres and retail parks as the segments offering most scope for growth while roundly dismissing the vast potential of e-commerce. As this industry leader put it in 2004: “Some products sell well over the internet, others don’t. It’s all part of retail evolution and most retailers are adapting to take advantage.” By 2013, however, e-commerce was turbo-charging Europe’s logistics market, and the industry proclaimed: “Warehouses are the new retail spaces.”

As one retail asset manager now acknowledges: “The internet has been transformative of the retail environment, but of a retail sector that was lazy and commoditised and ripe for disruption.”

There is no question that technology has had a profound impact across real estate over the last 20 years, but according to a property company CEO, "that's really been less about the products that technology has delivered, and more about the choice that technology has given customers. Physical retail, which provided less choice, has lost out to e-commerce, which provided more."

Moreover, an industrial sector that has already broadened to include last-mile delivery, dark kitchens and datacentres, is likely to expand further with advances in technology. Battery storage, electric vehicle charging stations, carbon sequestration, and satellite stations are all identified as potential investment opportunities.

With greater opportunities and diversity of real estate, comes investment risk, albeit in different guises than before. "We are already starting to see things like pharmaceuticals and car parts being 3D-printed," one technology expert cautions. "If you could have a big printer in the middle of a city that prints all of the things that you need, why would you need as many boats, trains and logistics warehouses?"

But against a background of continued online sales growth and onshoring, few interviewees are betting against sustained demand for ever-more sophisticated warehouses over the next 20 years.

Workplace evolution

As with retail, the ever-improving online experience is providing office workers with new choices, threatening to bring further disruption to what remains, albeit to a somewhat reduced degree, the largest real estate sector. Just how much disruption is a subject that polarises opinion in the industry.

On one side there is the view, advanced by a senior consultant, that the requirement for more space to accommodate "de-densification, more investment in making spaces attractive for younger workers to woo them into the office for collaboration spaces, coffee shops, gyms, amenities," will balance out the trend toward remote working.

For the sceptics, such opinions represent "grasping at straws". As an office sector analyst says: "It doesn't stack up when the average return to the office is for two and a half days a week. The average organisation can reduce by 30 percent, a whole swath more could easily reduce by 50 percent. For the real estate markets, for the developers, for the investors behind them, that's an incredibly scary proposition."

Some believe that reduced demand, combined with increasing obsolescence provoked by environmental regulation and the failure to meet customer demand for sustainable, healthy buildings, could cause serious pain for office investors over the coming years: "Some owners are sitting on assets which look like core because they are leased, but they are worse than junk bonds because when the lease expires, they won't be re-leased and they will need to be repurposed. In the next 20 years that will have a tremendous impact on valuation."

Others suggest that the pandemic-driven acceleration of the trend towards "place independence" in the working lives of professionals will have a profound effect on the evolution of workplaces, and not just valuation. "The geography of work has changed," says an office-sector veteran, who predicts the further development of the "space-as-a-service" concept. "Work will be done on tech platforms of lots of buildings linked up, with companies contracting with those platforms, a bit like Spotify, and their people working everywhere. Workplaces will become an amenity that people will expect to have nearby to where they live."

In many respects, the debate over the future of the workplace epitomises the inevitable but challenging move away from old-fashioned, single-use sectors. As one real estate operations expert suggests, the lines between workspace and other forms of amenity will become increasingly blurred. "We all live in a virtual world, whether we like it or not. Post-COVID, people are coming back to the city, but not to sit in the office. The restaurants and pubs are packed. Humans need to congregate and socialise. In 1600s London, business was done in coffee houses and pubs. We have come full circle. If we think about that, and how virtual our lives are, how do we marry the two?"

PARIS, FRANCE

Cities and placemaking

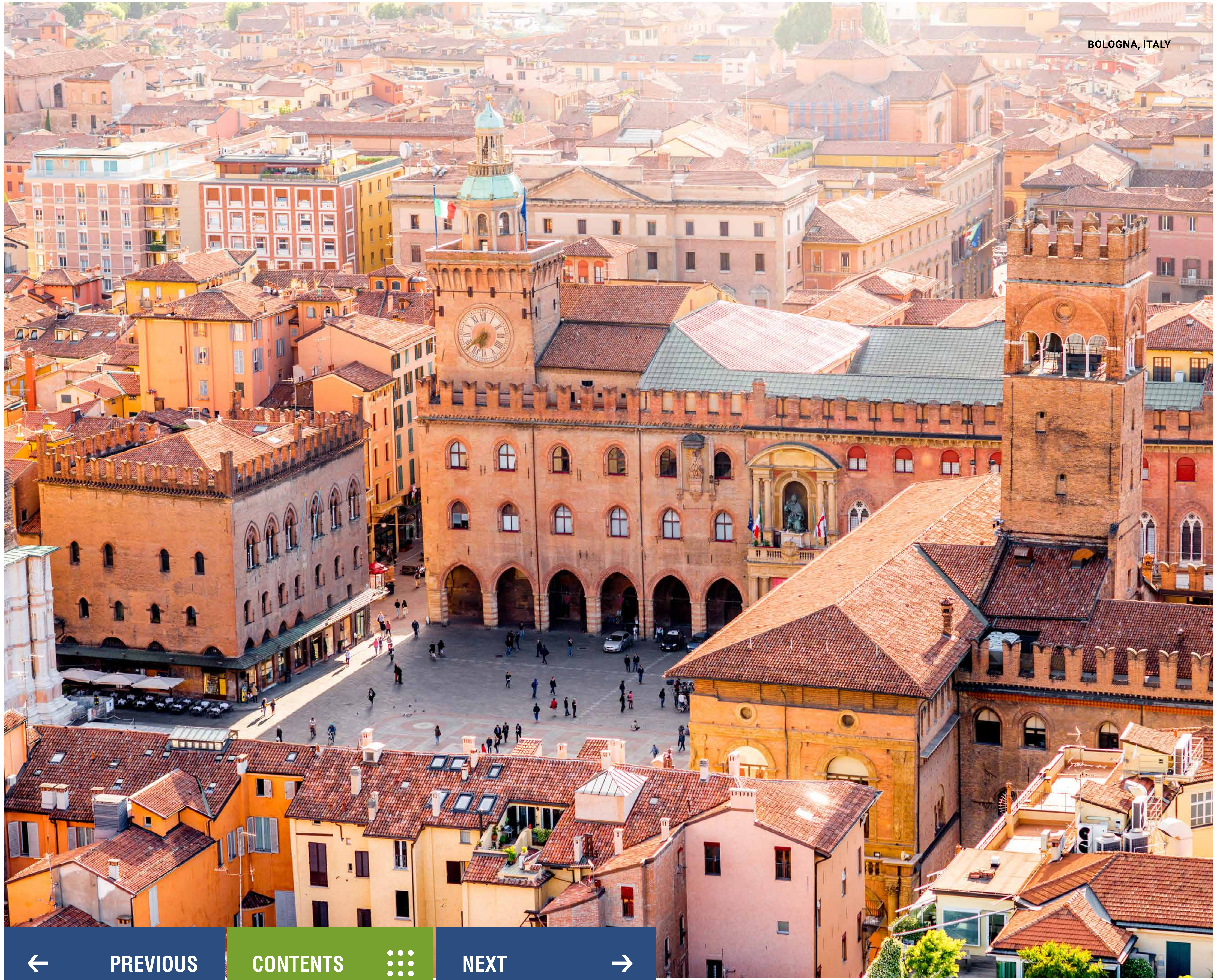
Urbanisation has been one of the key megatrends, embraced by the real estate industry as a driver of opportunity and especially over the past decade or so.

Just as the industry was hit by the global financial crisis (GFC) in 2008, another historical moment was marked by the United Nations (UN) when it reported that over 50 percent of the world's population lived in urban areas.

Ever since then, *Emerging Trends in Europe* has reflected the lasting impact of the GFC and urbanisation, albeit for very different reasons. In those intervening years the industry has, for the most part, seen urbanisation as a positive, long-term influence.

And yet the pandemic saw city centres empty of people, leading some to ponder at the time whether a paradigm shift was taking place. Could the next 20 years see a reversal of the trend? Unlikely, according to industry leaders. "The massive efficiencies of cities and agglomeration benefits are hard to replicate in another format," says a property company CEO, expressing a commonplace view among interviewees.

As *Emerging Trends Europe* has shown over the years, the real estate industry has made the most of the trend towards urbanisation. "We don't invest in countries anymore. We invest in urban areas," said an interviewee in 2016. It was a sentiment echoed across the industry, and one which became a cornerstone of many investment strategies.


BOLOGNA, ITALY

PRAGUE, CZECH REPUBLIC

"Urbanisation continues to be a buzzword for the industry," said an industry leader in 2017. "Successful cities facilitate the largest, most diverse number of people to collaborate effectively and share resources, whether that is infrastructure, technology, cultural facilities or ideas. In short, the most successful, growing cities embody the sharing economy."

Today, the UN reports that 56 percent of the world's population live in urban areas, and as much as 75 percent in the EU, which partly explains why the consequences of urbanisation have not been universally benign. Gentrification has priced lower-paid workers out of the inner cities, and the lack of affordable housing is now a widespread problem across Europe: "Cities have become more difficult places to live. They have struggled with the idea of fairness. It is one of the biggest challenges they face going forward," says an architect today. "We're playing catch-up to try and make our cities better places to live, on climate change, and on the way we design adaptable uses for future-proofing."

It is noteworthy how much more sophisticated the industry's understanding of placemaking has become over the years. In 2006, *Emerging Trends Europe* revealed that while mixed-use schemes were gaining "increased acceptance" among survey respondents, the "majority remain wary". But by 2008, that fateful year, respondents identified mixed-use and urban regeneration investments as having the best growth prospects. Urban context and community are now almost universally acknowledged to be of crucial importance, with success measured not at the scale of the individual asset but across the broader environment.

New mixed-use districts have sprung up in Europe's main cities, with London's redeveloped King's Cross name-checked by several interviewees — and many others over the years — as an outstanding example of what can be achieved. Access to infrastructure, "the footfall that the transit induces, that is a gigantic foundation for mixed-use". Partnerships with public sector authorities that are willing to be flexible, and understand developers' constraints, are acknowledged to be crucial factors for success.

There is support for the "15-minute city", an urban planning concept which, as the name suggests, involves people accessing all their essential needs within a 15-minute walk or bike ride. The aim is for a big city to have multiple, thriving mixed-use neighbourhoods and so improve the quality of life for its citizens while dramatically cutting car usage and carbon emissions.

In themselves such objectives are hardly new, but they gained currency during COVID. While some municipal authorities looked on as people left city centres, others such as Paris gave renewed backing to the 15-minute city. For its supporters, this concept is seen as a contemporary response not just to the pandemic but to the climate crisis.

And yet, a proven mechanism to link the social value and economic activity generated by infrastructure and placemaking to the value of real estate, remains elusive. Such an innovation would enable long-term investors to commit more capital to large urban projects. As an urban strategy consultant puts it: "Allocating investment benefits and risk is the new frontier. That will probably determine the future of city-wide development as much as any planning policy or placemaking strategy."

Many interviewees highlight social inclusion as a crucial challenge for the next 20 years. "Fewer and fewer people can afford to live in big cities. Unless we start dealing with that, it is going to hit the real estate industry. We need to have a discussion around inequality and how we create inclusive cities," says a social housing investor.

Real estate may struggle to address what is essentially a wider societal and economic problem, says another consultant. "We can create more affordable housing, but the issues that create inequality and polarisation in our society are not all attributable to real estate." Nonetheless, being seen to be part of the solution will become increasingly important to investors' reputations: "Attacking the inequality in society will become a performative part of what it takes to be a successful real estate developer."

Digitisation may offer some answers, and the smart city agenda is placing greater weight to social and environmental factors.

"Not so long ago the smart city philosophy was about efficiency. It has become more human-centred, about how people get around, how communities interact, who we are creating resilience for," notes an interviewee.

Artificial intelligence (AI) and data analysis could have a seismic effect on land use within urban areas, claims another: "A piece of generative technology will run through millions of iterations of what could be on a plot of land. It'll produce the optimal design to deliver the maximum economic benefits and will have figured out what the whole supply chain looks like to be able to deliver that 50 percent faster than you could do it today, for 30 percent less money."

Not all interviewees are convinced. "We are somehow believing that technology is going to solve it all, and I don't see that happening," says an architect. Instead, the industry should heed the example of hotels, which opened their doors to become an amenity for surrounding communities during the pandemic. "We should be building buildings for everyone, not for just a single use. You don't build a big office or residential building for the ground floor, you build it for the space above. Think of the ground floor as free, and of all the things that people could do with it, so that the building becomes an integral part of the community in an operational sense."

MODERN DEVELOPMENT WITH ELECTIC CHARGING POINTS


ZEELAND BRIDGE WITH WIND TURBINE, NETHERLANDS

In 2020, *Emerging Trends Europe* analysed the potential impact of technology on transport. The report concluded that real estate would have the opportunity to "embrace mobility solutions that help identify and enhance value for new locations while changing the way we move around the world, and thus the way that world is built." Micro-mobility, self-driving vehicles, drones and perhaps even hyperloop could have a major impact on real estate over the next 20 years.

"Within the next 10 years, autonomous vehicles will be ubiquitous," claims a green proptech entrepreneur, predicting that the culture of individual vehicle ownership will gradually be replaced as tech companies shift their models to "transport as a service". Eliminating the need for parking, driveways and garages could have a hugely beneficial effect on urban planning and may even help alleviate the affordability crisis. "We can use that space effectively to house people at a lower cost."

New ideas for urban living

The impact of COVID across Europe's cities still resonates clearly among industry leaders. Though most interviewees believe the pandemic may have caused only "a pause in urbanisation", others believe its legacy will shape the urban fabric in novel ways over the coming years.

> "We will also see the hydrogen economy come through in the next 20 years, with cleaner, lower-cost hydrogen-powered planes, trains, automobiles, and boats that move things around because it'll just make more sense.

"The acceleration of remote work and people's search for a good quality of life and sustainable environment mean in the tier one cities the actual desirable locations to live certainly do not include the downtown core. Now you have a much broader competition among locations to be the desirable place to settle and to work," says a US-based analyst.

Technological advances will fuel the suburbanisation of real estate, suggests the COO of a global asset management business: "We will also see the hydrogen economy come through in the next 20 years, with cleaner, lower-cost hydrogen-powered planes, trains, automobiles, and boats that move things around because it'll just make more sense. You will probably also have a hydrogen fuel cell in your home, which will power your needs so you can move to locations that are further and further off-grid."

Climate change could displace two to three billion people globally from areas that are no longer habitable, according to a futurologist: "What does that mean for housing? How are we going to design our villages and our cities to integrate new cultures?"

Those refugees may supplant declining populations across European countries where the demographic is ageing, suggests an analyst. "Cities that attract young people will be the winners of tomorrow, and societies that cannot are going to be the vacant losers of tomorrow or be taken over by other nomadic climate refugee populations."

Radical new models for urban living could be needed in the light of accelerated climate change, and as this analyst predicts, the emergence of "an asset class of moveable communities", featuring solar power, wastewater recycling, and hydroponic and aquaponic food production. "You want to be able to relocate your assets in the event of natural disasters and tropical storms."

A tech entrepreneur envisages resilient neighbourhoods capable of producing their own food, designed and managed by sophisticated, adaptive AI. "We should not be paving over farmland, but actually producing more artisanal ingredients than would have been there before, grown in a controlled environment next to each house. There is a central square where you have piazza kitchens, a year-round farmers market, commercial spaces, clinical and dental health, a shared work environment, an organic supermarket, this beautiful concept of neighbourhoods that are living within nature, and not separate from it."

Such visions may appear utopian, but as another workplace analyst says, the response of some cities to the pandemic — banning cars from city centre streets to be replaced by community activities — shows how abrupt change can stimulate bold solutions. "The hope is not [just] that we'll see a reduction in some of the global pressures we're facing, but actually that governments and business leaders will become bold in their replies. And that they'll then stick with some of those bold replies and change our lives for the better as a result."

> Cities that attract young people will be the winners of tomorrow, and societies that cannot are going to be the vacant losers of tomorrow or be taken over by other nomadic climate refugee populations.

FEMALE BAKERY STALL HOLDER AT FARMERS FRESH FOOD MARKET

APPENDIX
CITY PROSPECTS

EUROPE FROM SPACE

City Prospects

The city rankings are based on overall prospects, which are determined by how much they deviate from the average/mean score; these are shown in Figure 8-1.

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 2023 compared with 2022 on a scale of 1 = decrease substantially to 5 = increase substantially, and the scores for each city are averages.

Figure 8-1 **City rankings in 2023**

Source: *Emerging Trends Europe survey 2023*

Investment			Development			Rent			Capital values		
Rank	City	Score	Rank	City	Score	Rank	City	Score	Rank	City	Score
1.	London	2.22	1.	London	2.08	1.	London	1.92	1.	London	1.74
2.	Paris	1.77	2.	Berlin	1.66	2.	Paris	1.56	2.	Paris	1.40
3.	Berlin	1.71	3.	Paris	1.66	3.	Berlin	1.48	3.	Berlin	1.32
4.	Madrid	1.55	4.	Madrid	1.53	4.	Amsterdam	1.38	4.	Madrid	1.24
5.	Amsterdam	1.54	5.	Munich	1.45	5.	Madrid	1.37	5.	Amsterdam	1.23
6.	Munich	1.52	6.	Amsterdam	1.42	6.	Munich	1.35	6.	Munich	1.18
7.	Frankfurt	1.34	7.	Frankfurt	1.26	7.	Frankfurt	1.15	7.	Frankfurt	1.06
8.	Hamburg	1.23	8.	Hamburg	1.15	8.	Hamburg	1.06	8.	Barcelona	0.97
9.	Barcelona	1.14	9.	Barcelona	1.10	9.	Barcelona	1.03	9.	Hamburg	0.95
10.	Milan	1.11	10.	Milan	1.09	10.	Milan	0.95	10.	Milan	0.91
11.	Lisbon	0.99	11.	Lisbon	0.97	11.	Dublin	0.89	11.	Dublin	0.80
12.	Vienna	0.96	12.	Dublin	0.90	12.	Lisbon	0.85	12.	Lisbon	0.80
13.	Dublin	0.94	13.	Vienna	0.90	13.	Vienna	0.83	13.	Vienna	0.78
14.	Copenhagen	0.84	14.	Copenhagen	0.76	14.	Brussels	0.80	14.	Brussels	0.70
15.	Brussels	0.82	15.	Brussels	0.74	15.	Warsaw	0.77	15.	Warsaw	0.65
16.	Warsaw	0.79	16.	Warsaw	0.74	16.	Copenhagen	0.68	16.	Zurich	0.62
17.	Zurich	0.74	17.	Zurich	0.67	17.	Zurich	0.67	17.	Copenhagen	0.61
18.	Manchester	0.73	18.	Manchester	0.66	18.	Manchester	0.65	18.	Manchester	0.60
19.	Stockholm	0.69	19.	Stockholm	0.66	19.	Stockholm	0.63	19.	Rome	0.56
20.	Luxembourg	0.66	20.	Luxembourg	0.60	20.	Luxembourg	0.61	20.	Stockholm	0.52
21.	Rome	0.64	21.	Rome	0.60	21.	Rome	0.54	21.	Luxembourg	0.51
22.	Birmingham	0.48	22.	Birmingham	0.48	22.	Lyon	0.45	22.	Athens	0.44
23.	Athens	0.47	23.	Athens	0.46	23.	Athens	0.44	23.	Lyon	0.42
24.	Lyon	0.46	24.	Lyon	0.44	24.	Birmingham	0.44	24.	Birmingham	0.40
25.	Helsinki	0.45	25.	Helsinki	0.43	25.	Edinburgh	0.40	25.	Edinburgh	0.36
26.	Edinburgh	0.43	26.	Edinburgh	0.40	26.	Prague	0.38	26.	Helsinki	0.35
27.	Prague	0.43	27.	Prague	0.40	27.	Helsinki	0.37	27.	Prague	0.34
28.	Budapest	0.31	28.	Budapest	0.31	28.	Istanbul	0.30	28.	Istanbul	0.31
29.	Istanbul	0.25	29.	Istanbul	0.26	29.	Budapest	0.29	29.	Budapest	0.28
30.	Oslo	0.23	30.	Oslo	0.24	30.	Oslo	0.22	30.	Oslo	0.19

ABOUT THE REPORT

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About the survey

Now in its 20th edition, *Emerging Trends in Real Estate® Europe* is a highly regarded and widely read trends and forecast publication in the real estate industry.

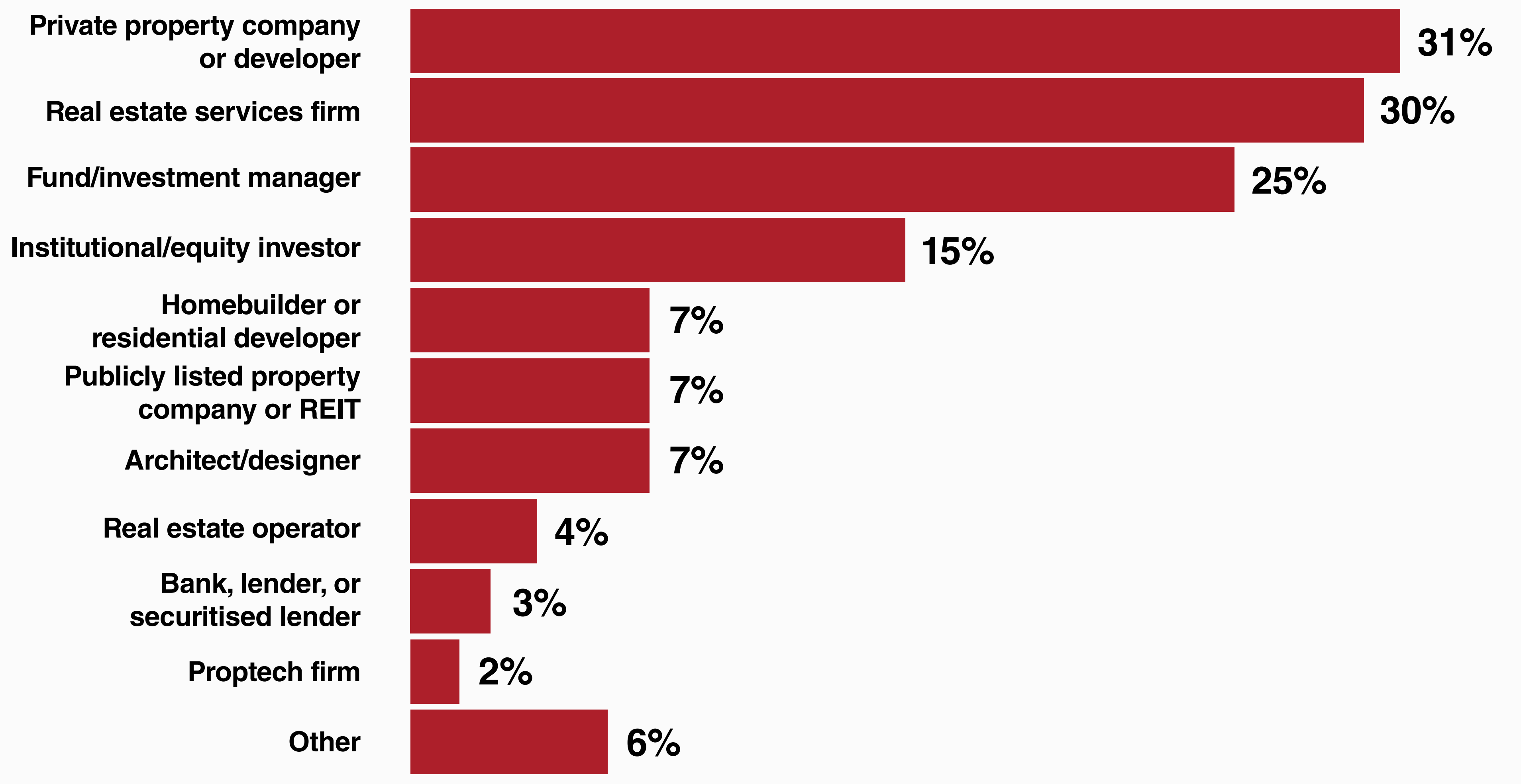
The report, which is undertaken jointly by PwC and the Urban Land Institute (ULI), provides an outlook on real estate investment and development trends, real estate finance and capital markets, cities, property sectors and other real estate issues throughout Europe.

To mark its 20th year in circulation, this year's issue includes an analysis of key historical trends and evolutions within the European real estate sector over the past two decades – such as changes in city and sector rankings.

Emerging Trends in Real Estate® Europe 2023 reflects the views of 1,038 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.

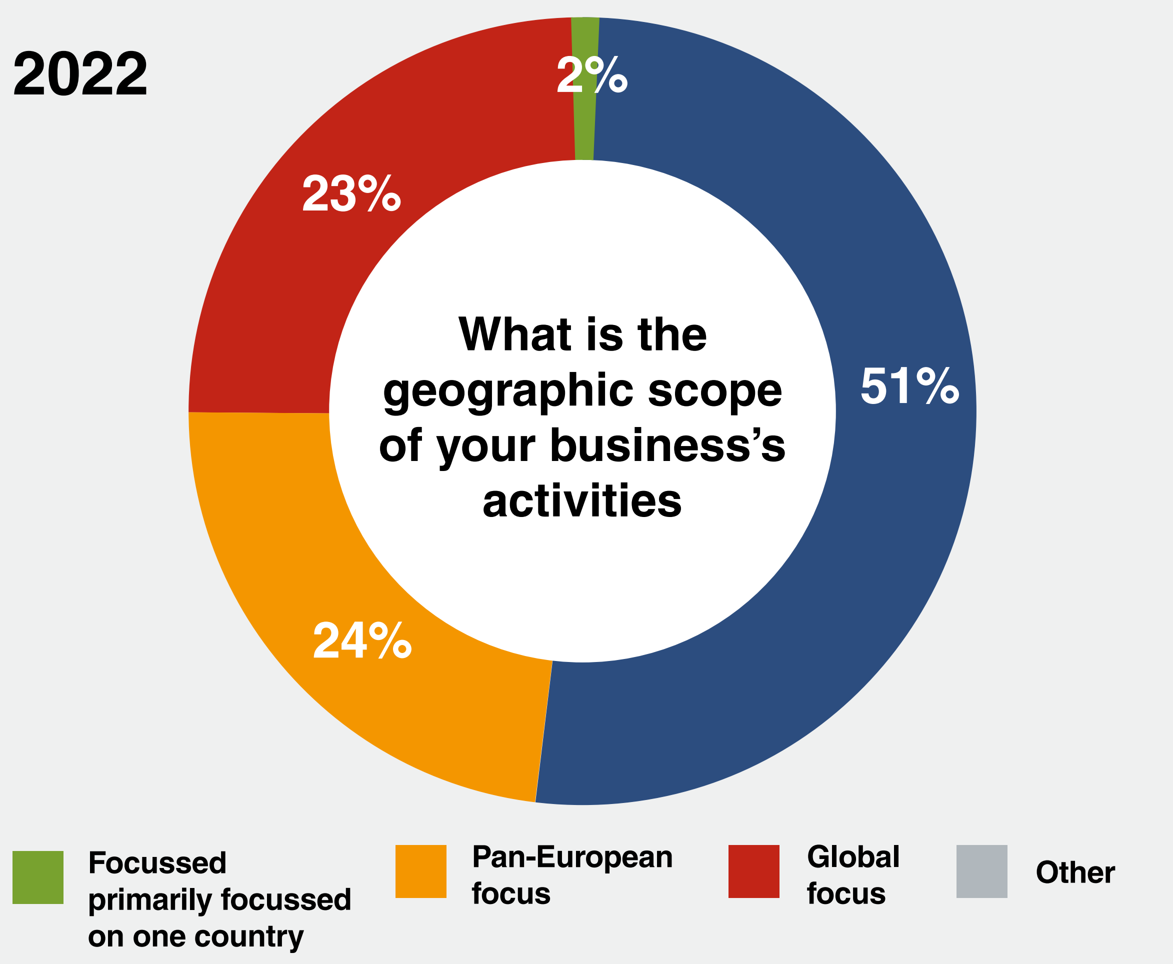
The interviewees and survey participants represent a wide range of industry experts, including investors, fund managers, developers, property companies, lenders, brokers and consultants. A list of the interviewees and roundtable participants in this year's study appears on the following pages. To all 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?



Source: *Emerging Trends Europe survey 2023*

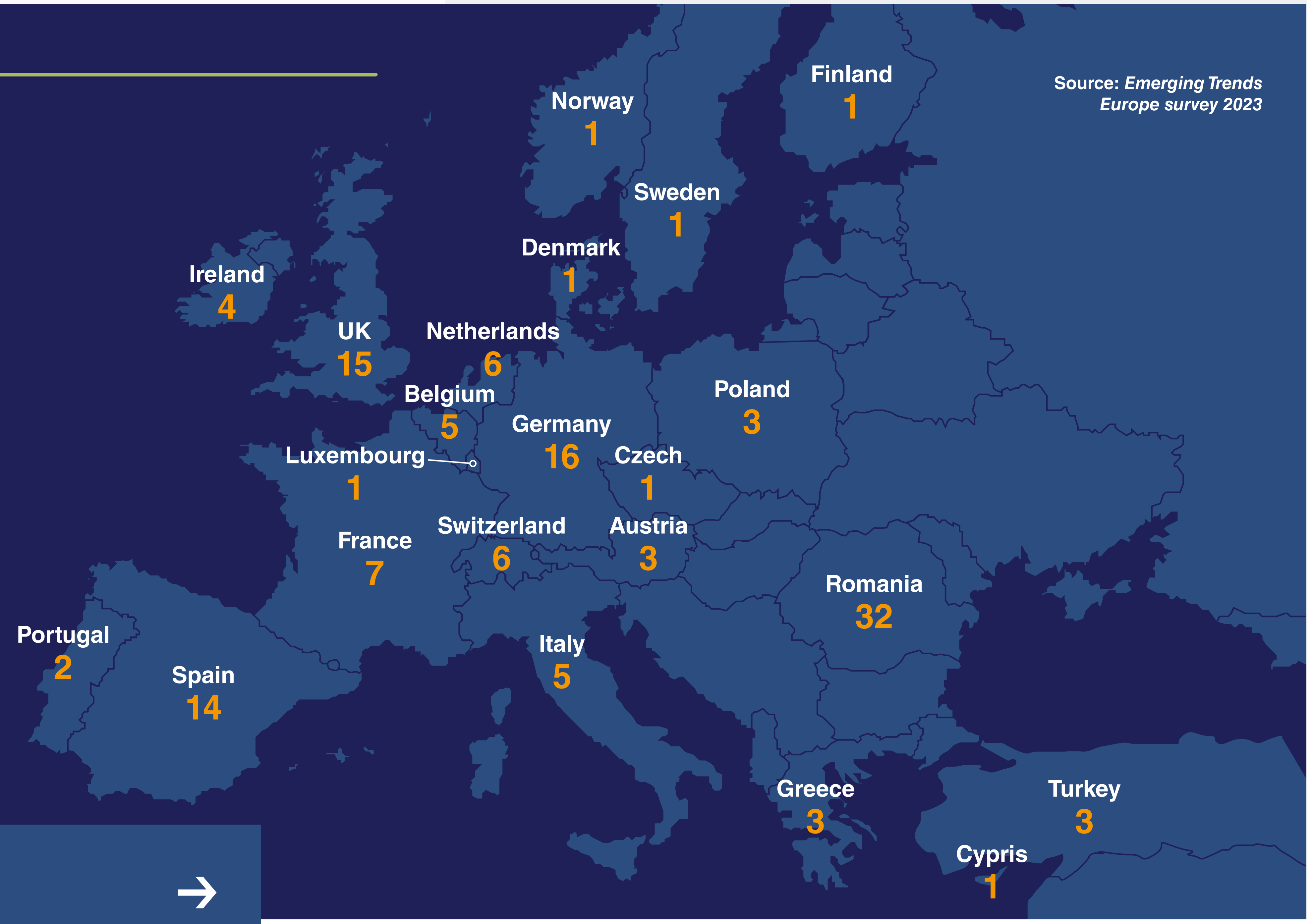
Survey responses by geographic scope of firm



Source: *Emerging Trends Europe survey 2023*

Survey responses by geographic scope of firm (%)

Country	%	Country	%
Austria	3	Luxembourg	1
Belgium	5	Netherlands	6
Cyprus	1	Norway	1
Czech Republic	1	Poland	3
Denmark	1	Portugal	2
Finland	1	Spain	14
France	7	Sweden	1
Germany	16	Switzerland	6
Greece	3	Turkey	3
Ireland	4	United Kingdom	15
Italy	5	Other	2



Source: *Emerging Trends Europe survey 2023*

Interviewees and roundtable participants

A/O PropTech
Gregory Dewerpe

Aktiebolaget Fastator
Svante Bengtsson

AB Sagax
Jaakko Vehanen

Aéroports de Paris
Hubert Fontanel

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AF Eiendom
Otto Christian Groth

AFIAA Investment Foundation for International Real Estate Investments
Ingo Bofinger
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AGC Equity Partners
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ALFA Development
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Andreea Kaiser
Jan Kristensen

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Alexander Huber

BCP Capital
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Befimmo
Jean-Philip Vroninks

Beisheim Holding
Martin Bruns

Berlin High End
Jon Svenningsen

Berlin Hyp
Ariana Popal

Big Yellow Group
James Gibson

Blackstone
James Seppala

BLOXHUB
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Nathalie Charles
Stephen Coticoni

Bohill Partners
Emily Bohill

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Dominik Erne

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Tomas Hermansson

Borio Mangiarotti
Edoardo De Albertis

Bovieran Danmark
Susanne Joseph Schou

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Simon Carter
Mariam Hussain

Brookland
Nassar Hussain

Brunswick Real Estate
David Hävermark
Hanna Rauhala

Bruun & Hjejle
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Torben Black

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CapMan
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Home.Earth
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Ioane Menabde

ifa
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Ikano Bolig
René Brandt

Ilmarinen
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ULI's interdisciplinary membership represents all aspects of the industry, including developers, property owners, investors, architects, urban planners, public officials, real estate brokers, appraisers, attorneys, engineers, financiers, and academics. Established in 1936, the Institute has a presence in the Americas, Europe, and Asia Pacific regions, with members in 81 countries. ULI has been active in Europe since the early 1990s and today we have nearly 5,000 members and 15 National Councils.

The extraordinary impact that ULI makes on land use decision making is based on its members sharing expertise on a variety of factors affecting the built environment, including urbanisation, demographic and population changes, new economic drivers, technology advancements, and environmental concerns. Drawing on the work of its members, the Institute recognises and shares best practices in urban design and development for the benefit of communities around the globe.

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