

Emerging Trends in Real Estate[®]

Reshaping the future

Europe 2018



Contents

2

Executive
summary

4

Chapter 1
Business
environment

16

Chapter 2
Real estate
capital markets

26

Chapter 3
Markets to
watch



Emerging Trends in Real Estate®

Europe 2018

Reshaping the future

A publication from PwC and
the Urban Land Institute

74

About the
survey



64

Chapter 4
Rethinking
real estate

“There is a flight to quality for investors. Equity always has to be invested even when yields are going down. For us to find investors is not really a problem, it is deploying the capital.”

Head of pan-European fund at global asset manager

Executive
summary

Executive summary



Europe’s real estate industry remains “cautious but positive” as it comes to terms with today’s low-return market and the longer-term disruptive forces of technology and social change.

“With technology, we are potentially moving from people being where they have to be to being where they choose to be. Property is going to switch from servicing the needs of people to servicing the wants of people.”

Director, global investment manager

Emerging Trends Europe reveals an industry that is buoyed by a brighter general economic outlook and, in turn, stronger occupier demand for much of Europe than previous years.

Continental European markets are benefiting from a relative slide in sentiment towards the UK, where, despite some semblance of normality returning to investment volumes in 2017, there is nonetheless widespread concern over the economic impact of Brexit in 2018 and beyond.

In contrast, following the election of Emmanuel Macron, interviewees are more upbeat about France than they have been for years. Germany, meanwhile, is consolidating its position as Europe’s safe haven for capital.

According to *Emerging Trends Europe*, Germany accounts for four of the top six leading cities for overall investment and development prospects in 2018, with Berlin once again at Number 1. Though values in the German capital have rocketed over the past year, industry leaders believe the growth is sustainable, supported by a rising population and a vibrant technology sector.

The dominance of the German cities is broken by Copenhagen, which claims second place – jointly with Frankfurt – following an impressive ascent of the rankings over the years. Domestic and international players alike are drawn to the Danish capital for its strong employment growth and lively tourist trade.

Despite the brighter general outlook in this late-cycle market, there are enough warning signals to prevent confidence slipping into complacency. Historically low yields, a collective pressure to invest and a scarcity of available core assets are all uppermost in the minds of the industry leaders canvassed for *Emerging Trends Europe*. A rise in interest rates is a prospect that was not evident a year ago. And when it comes to the geopolitical backdrop to business, international instability remains a big concern.

At the same time, the European industry is looking far beyond 2018 – and well beyond traditional real estate boundaries. Many leaders believe change is long overdue, but *Emerging Trends Europe* reveals an industry that is beginning to open its eyes to new entrants, new partnerships and new business models.

The rise of co-working has been a notable phenomenon – as part of a wider real estate response to changes in how we work, technology and the in-vogue, “space-as-a-service” movement. A mixed-use approach to development is another noticeable movement undergoing a 21st century re-boot, recognising continued urbanisation trends, changing patterns of urban living and a more sophisticated understanding of the economic benefits of “good” densification. And increasingly, boundaries between real estate, social infrastructure and wider investment in infrastructure are becoming blurred.

Real estate is being reshaped by social, demographic and technological change. And as the industry leaders interviewed for *Emerging Trends Europe* make clear, they are not simply talking about, but acting upon, this challenge.

Chapter 1

Business environment



“We’re in an environment where you’re not going to achieve growth through any cap-rate shift. We’re going to have to do it through some sort of value-creation activity, and that’s never easy. Having said that, we have strong demand for quality real estate.”

“We have possibly reached the peak of the global growth cycle, but we see solid growth in European markets.”

Optimism is spreading through Europe’s property industry, buoyed by an improving macro-economic outlook for the Eurozone and real estate’s continuing attraction as an investment asset class.

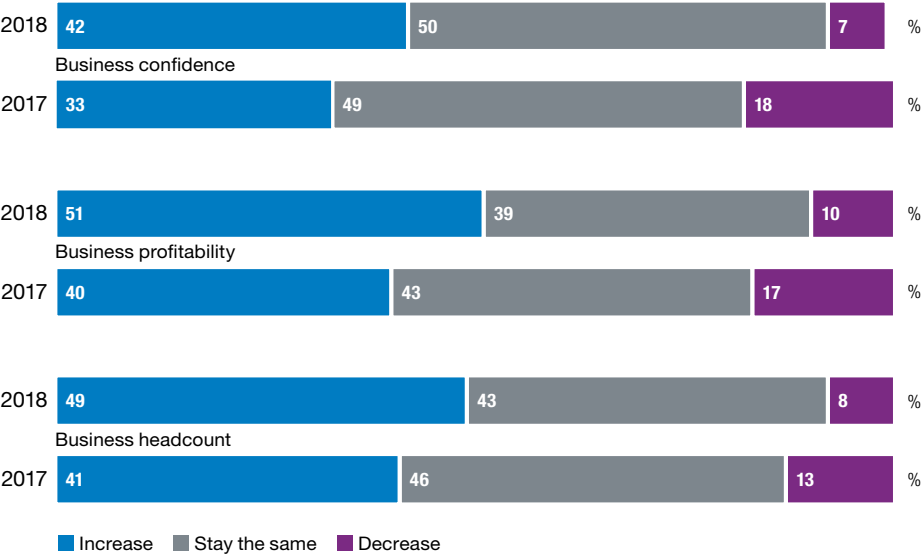
Despite concerns over prime real estate values and a potentially volatile geopolitical backdrop, around half of the property professionals surveyed by *Emerging Trends Europe* indicate that profits and headcounts will increase in 2018. Half of the respondents expect business confidence to remain the same, but as much as 42 percent expect an increase – a 10 percent jump on last year.

The industry is, as a Dutch pension fund manager suggests, “cautious but positive”, drawing comfort from the improved economic climate across mainland Europe.

“We have possibly reached the peak of the global growth cycle, but we see solid growth in European markets and they might be in a better position than the US because we still have some way to go in a lot of countries,” says a pan-European investment manager.

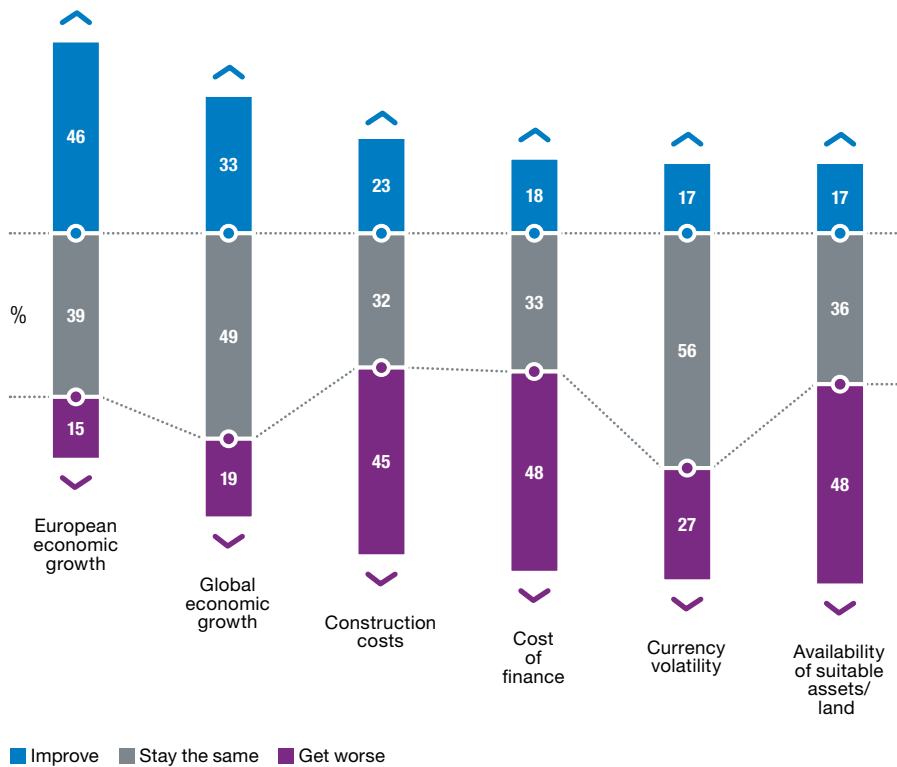
Another interviewee adds: “You have very strong GDP growth coming through – forecasts of 1.5 to 2 percent are a lot in the context of Europe and past low productivity and weak demographics. Anywhere that’s been showing GDP growth of above 1.5 percent on a national basis has really seen a strong flow of capital: Germany, Spain, and Ireland.”

Figure 1-1 Business prospects in 2018



Source: *Emerging Trends Europe* survey 2018

Figure 1-2 European business environment in the next 3-5 years



Source: Emerging Trends Europe survey 2018

This optimistic outlook extends beyond 2018, with nearly half of the respondents expecting European economic growth to improve over the next three to five years. Such a positive assessment follows an upturn in overall investment volumes in 2017 and improving occupier demand in many of Europe’s major cities, albeit not in the London office market.

But Brexit remains a serious concern in the UK, and particularly London. As one private equity investor says: “The UK has had a growth premium over Europe. That growth premium has gone now.”

Over a year on from the UK’s referendum vote to leave the EU, the perceived lack of progress over Brexit, hard or soft, is a source of huge frustration across the industry. “We don’t see the next 18-month period as the end of Brexit; we see it as the beginning,” says a London-based global investor. “That issue is going to weigh on investment sentiment and decision-making by all agents in the economy, ourselves included, for a number of years unless there is an unexpected upside surprise, but that seems quite unlikely.”

Aside from the direct consequences for capital flows and occupier movements, the industry is concerned, too, about the long-term impact of Brexit. “Brexit has made continental Europe more confident, but that is a false feeling of comfort because the UK is such an important strategic trade partner. It is a really sad thing,” says a Belgian interviewee.

Though the pros and cons of Brexit are yet to be played out, they are nonetheless subject to widespread speculation by Eurozone and UK interviewees (see page 10). They find some solace, however, from recent elections. Those in The Netherlands, France and Germany have, to varying degrees, allayed fears – starkly evident in last year’s report – over the rise of right-wing political parties in those countries. Only a quarter of survey respondents see a worsening European political environment in the next three to five years. “The positive growth in Europe comes at a time when the political structure has held,” says one US investor. “There is stability, and there is less focus on structural deficiencies in the economy, although those challenges remain.”

In particular, the election of the pro-EU, pro-business Emmanuel Macron as French president is seen as pivotal to a new “positivity in France”. As one UK interviewee observes: “There is this swing to Paris and the French with Macron, which wasn’t there a year ago. They’re going out of their way to woo people.” A logistics specialist adds: “In Europe, Macron is important. He needs to get the French engine going.”

Political instability in Europe may be easing, but it remains a key issue for 2018 among property players overall. *Emerging Trends Europe’s* interviewees express particular concern over the political risks to business and investment in Turkey, Hungary and Poland.

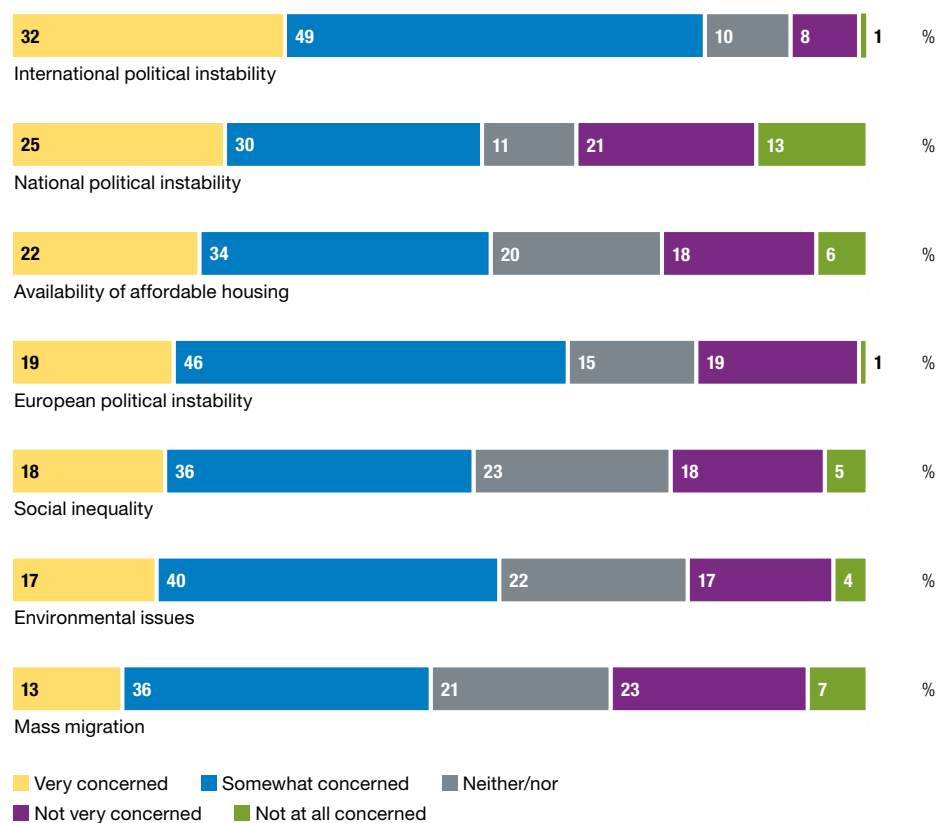
If anything, however, the industry’s geopolitical focus has shifted from the regional to the global. When it comes to social issues in 2018, the threat of international instability is by far the biggest concern among survey respondents and interviewees.

“We try to follow it very carefully, to understand and to anticipate potential consequences. But in the short-term, we are just managing our business in a more and more uncertain and unpredictable environment,” says one pan-European investment manager.

A global investor says: “Look at the Middle East, Trump and Asia, and not just North Korea. I continue to think that China is one of the more likely sources of the next downturn, just the pressures on the financial markets, particularly the banks. I would argue that the political risk, more globally, hasn’t gone down, even though it has gone down in Continental Europe.”

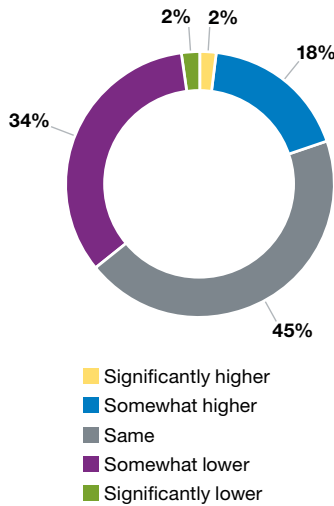
And yet, as another German institutional investor observes: “The market remains very strong. If you look back at 2017, the main takeaway was that there was lots of uncertainty about geopolitics and politics, and in spite of that, we will have invested a record amount.”

Figure 1-3 Social issues in 2018



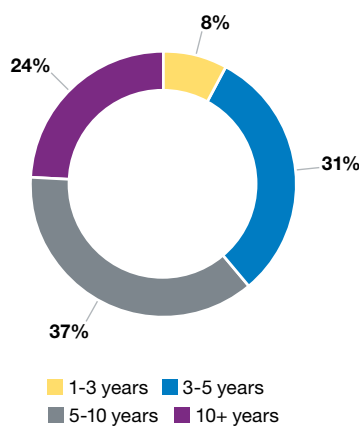
Source: *Emerging Trends Europe* survey 2018

Figure 1-4 Returns targeted in 2018 compared to previous year



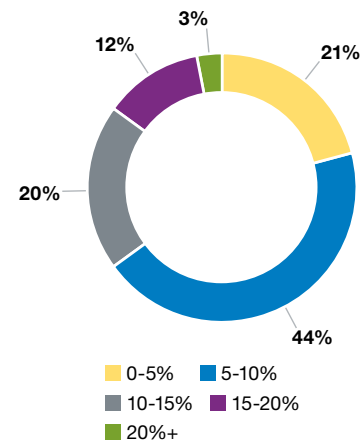
Source: *Emerging Trends Europe survey 2018*

Figure 1-5 Time horizon for holding investments



Source: *Emerging Trends Europe survey 2018*

Figure 1-6 Returns targeted in 2018



Source: *Emerging Trends Europe survey 2018*

“We’re focusing on high-quality assets in the strongest markets that will continue to grow through whatever the next downturn there is.”

If anything, the international geopolitical concerns have reinforced the flight to quality that has been evident in *Emerging Trends Europe* for some years. “We’re selling the assets that are less strong because it’s a good time to be a seller. And where we are a buyer, we’re focusing on high-quality assets in the strongest markets that will continue to grow through whatever the next downturn there is,” says a global investment manager.

As in previous years, income is the main draw in the prevailing low-interest rate environment. “I’ve not seen such consistency in what the clients are saying – from Asia and Australia to Europe and North America – the income theme is phenomenally strong,” says one pan-European fund manager.

But once again, return expectations are being scaled down – 36 percent of respondents say they are targeting lower returns in 2018 – although most interviewees say the yield gap between real estate and bonds, as well as financing costs, remains compelling. The question is, for how much longer?

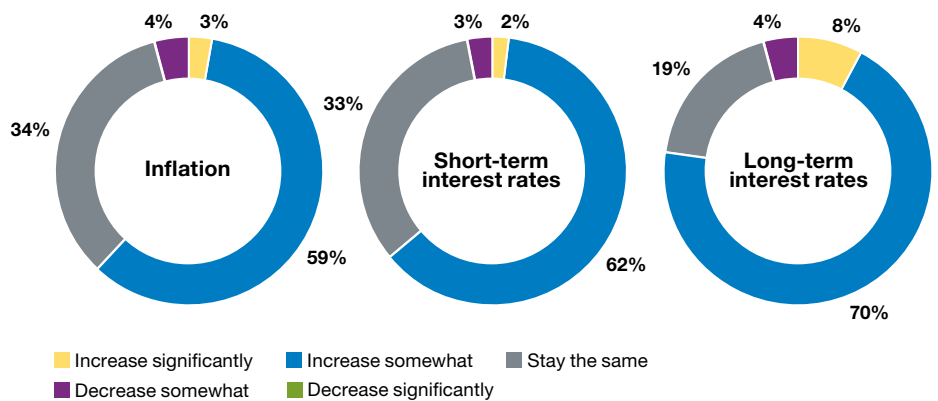
The European real estate industry overwhelmingly expects a rise in interest rates in 2018, and, unless there is a geopolitical shock to the monetary system, many see “a slow movement towards normalisation”. One Dutch pension fund manager states: “Low but rising rates will make other sectors more attractive, but we will still see a big spread between bonds and property yields. Property’s position will weaken but not significantly.”

Others are less sanguine. “There is a global problem of yields at record lows. When you have a combination of low interest rates and rents relatively late in their cycle, it is a dangerous business environment for a property investor,” says a global investment manager.

A partner at a pan-European private equity firm says: “The feeling of most investors is that we are towards the top of the real estate cycle. I’m not sure anybody sees a crash coming imminently, or necessarily where that will come from ... but some people are taking a cautious approach given where we are.”

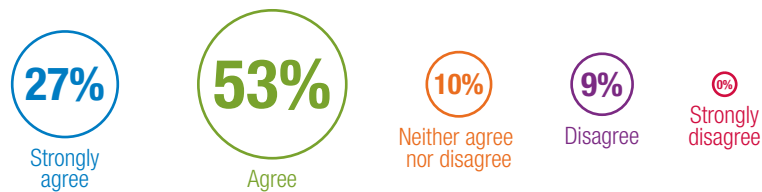
Over half of those surveyed by *Emerging Trends Europe* believe that prime assets are overpriced, or as one opportunistic investor puts it, “core, bond-surrogate real estate is riskier than what people call risky real estate”. Interviewees in Germany – a magnet for core investors over the past year – talk of “prices getting irrationally high”, but the challenge of finding value is apparent across Europe. As one private equity manager observes: “A 3 percent cap rate looks like a very optimistic ask. You see these numbers in Paris, Berlin and central London ... these cities look a little cooked, and you’d have to be very bullish about your exit to be able to buy assets there.”

Figure 1-7 Interest rates and inflation in 2018



Source: *Emerging Trends Europe* survey 2018

Investors are taking on more risk to achieve target returns



There is little sign of capital flows into core real estate ebbing, just yet. “Although people are looking at alternative asset classes to find a bit more yield, the general trend is urbanisation in the major gateway cities – across the globe,” says an investment banker. “So, the majority of capital is attracted to those gateway cities, and the secondary cities’ challenge is that they can become illiquid for long stretches. You need to be compensated for that risk of illiquidity.”

And according to one fund manager active across the Eurozone: “We still find pockets of the market where there is mispricing, and that’s been an interesting feature of this cycle, that secondary has not just uniformly followed prime down.”

The key concern for Europe’s real estate industry – as it has been for several years – revolves around the availability of suitable assets. More than three-quarters of those surveyed believe investors are taking more risks to achieve target returns, but the interviews indicate, if anything, a much more measured approach to risk-taking than last year.

“Economic development is strong and The Netherlands is finally out of the crisis,” says a Dutch investment manager. “However, on an international level there is much turmoil with events – Brexit, North Korea – which could each very suddenly stop this positive development. In underwriting decisions, considerations are more prudent than the economic climate may indicate.”

Beclouded by Brexit

Brexit remains a live issue for many in Europe’s property industry. There is a strong consensus that it will be at least partly responsible for both investment and values falling in the UK during 2018, and rising across the rest of the European Union.

After the initial shock of the June 2016 referendum, London’s status as a destination for global, “safe harbour” capital remains unchallenged.

But one London-based investment manager warns: “We have had very little slowdown or price correction to date, and it feels to me like a false market. It is going to be a protracted slowdown from here, and we are starting to feel the impact of that.”

Emerging Trends Europe’s survey suggests that the degree of Brexit-induced pessimism around the UK has lightened significantly since last year; though some 80 percent believe property values and investment will fall in 2018, only 12-20 percent think this drop will be substantial. UK respondents tend to be more positive than their continental counterparts.

Emerging Trends Europe’s UK interviewees, however, offer a much more downbeat assessment of UK plc.

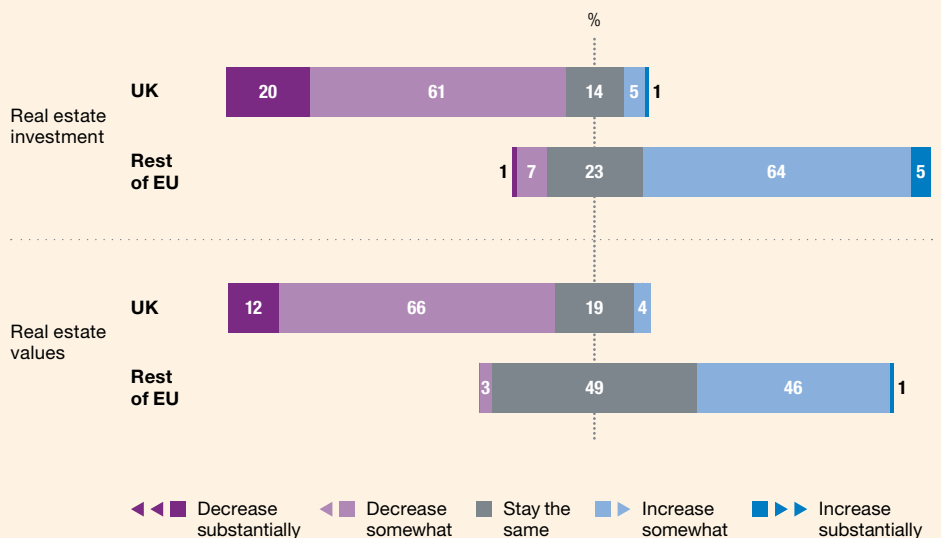
“What everyone finds so troubling about the Brexit situation is there is no clear path to what it is going to look like,” says the London head of a global fund manager. “Businesses don’t like uncertainty, and there is no end in sight to that.”

The CEO of a UK REIT states: “We are in a period where because of the uncertainty, business is making less investment and delaying decision-making. Those things generally are recessionary. Whether we will have a recession I don’t know, but we will be in a very low-growth environment.”

By contrast, the prolonged uncertainty has strengthened the conviction of those who believe the occupier and investment markets in Frankfurt and Dublin will gain from EU-related businesses and jobs relocating from London. “In Ireland and Germany, Brexit has pushed out the end of the cycle by maybe another two to three years,” says a big international investor. “Cities like Frankfurt and Dublin are more popular because of Brexit, in terms of demand for office space.”

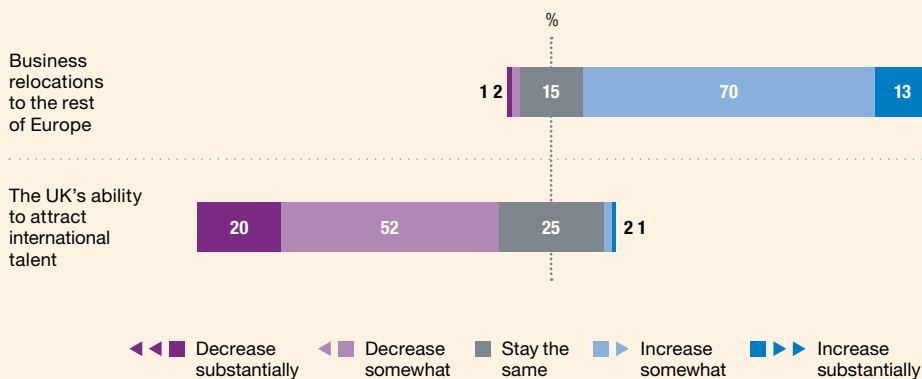
Paris, Berlin, Luxembourg and Madrid are frequently mentioned as potential Brexit beneficiaries. But if anything, the interviewees in the rest of Europe indicate a far wider circle of would-be Brexit winners than initially anticipated a year ago.

Figure 1-8 Impact of Brexit on real estate in 2018



Source: *Emerging Trends Europe* survey 2018

Figure 1-9 Business impact of Brexit in 2018



Source: *Emerging Trends Europe* survey 2018

Those in Barcelona, Milan and Warsaw all believe their cities stand to gain, while a Helsinki-based investment manager says: “The Brexit money flowed first to Germany, and after the yield compression in the market it has begun to flow to the Nordics.”

But no one believes there will be an outright winner, and few question London’s long-term status, although 72 percent of survey respondents think Brexit will reduce the UK’s ability to attract international talent in 2018.

One global investment manager declares: “There’s no way London is going to lose its place as the financial capital of Europe, but we’re undoubtedly beginning to see rents soften. But then, we shouldn’t be too surprised by that. I think it’s a short-term blip, and London will remain strong whatever happens.”

Another point of consensus is the uncertainty continuing. As one pan-European player suggests: “The Brexit political situation is not going to be resolved any time soon. There are a lot of big corporate occupiers that are in the UK perhaps because of the concentration of business, not because they need to be here. Over time, that could start to change. Paris, Berlin, Madrid, maybe Milan, will all get some. But I think that’s a process that will take 20 years, not two or three.”

“There’s no way London is going to lose its place as the financial capital of Europe, but we’re undoubtedly beginning to see rents soften.”

Top trends

Leading logistics

Technology is often cited by survey respondents as the one trend that will have the biggest long-term impact on real estate, but its influence is already strikingly evident in the short-term outlook for logistics.

A perennial high-achiever in *Emerging Trends Europe*, the sector is ranked Number 1 for investment and development prospects in 2018, largely on the back of the growth in online retail sales.

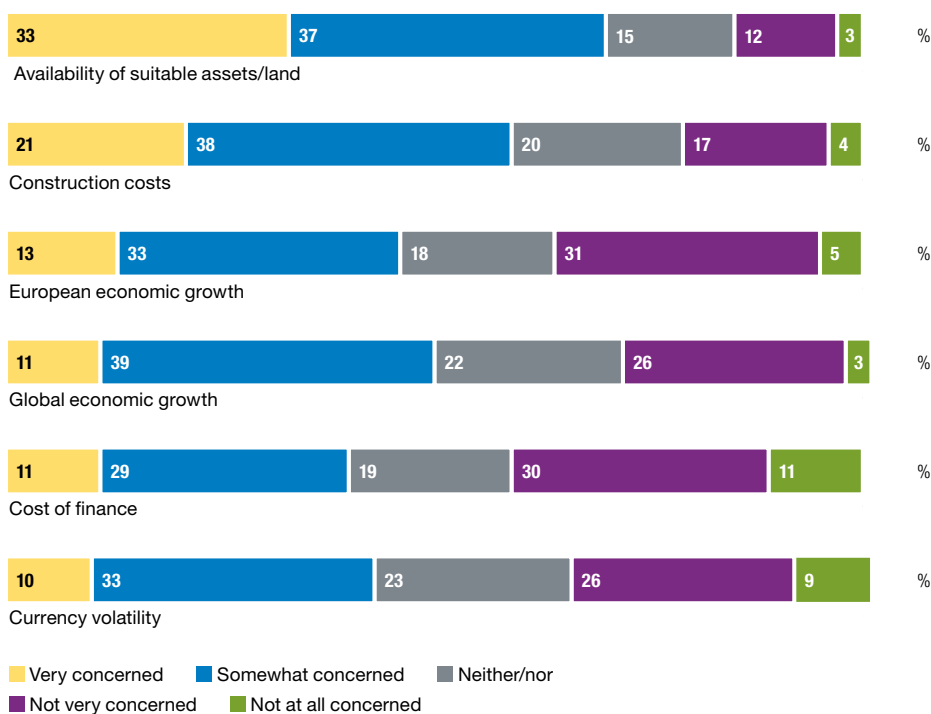
“Technological change is clearly playing out in the retail sector, and as retail shrinks, logistics expands, as does the last-mile delivery convenience to the consumer,” says one global capital markets adviser.

If there are any doubts, they are usually around the sheer weight of capital bearing down on the sector year after year, and its effect on values.

“The pricing has got so aggressive,” says a pan-European investor. “I am not convinced that a box in the middle of nowhere can be worth a 4 percent cap rate. There’s a piece of me that thinks we’re at peak logistics pricing now. You can build as much of it as you want, so trying to get rental growth through the sector is hard, unless it’s urban logistics, and urban logistics is expensive.”

But beyond 2018 the outlook is more mixed, as is the perceived influence of technology on the sector.

Figure 1-10 Issues impacting business in 2018



Source: *Emerging Trends Europe* survey 2018

“There is a trend towards consolidation in the hands of fewer, larger players,” says one bullish institutional investor. “For me it’s not a rental growth story, more of supply chains being modernised and e-commerce creating demand, so occupancy rates will remain high and the sector becomes more stable.”

Another investor cautions: “People have to be careful about the technological advances and obsolescence, even in logistics. Not all logistics markets are the same; there will be winners and losers – more than people might think.”

Residential tipping point

Until recently, residential was seen by many institutional players as a niche sector, and for some, too specialist. Today, the industry appears less bothered by the obstacles to investment and increasingly swayed by the opportunities that could emerge from huge housing shortages across Europe.

The *Emerging Trends Europe* survey reveals availability of affordable housing as one of the key social problems facing the industry in 2018 – more of a concern than environmental issues and mass migration.

At the same time, many interviewees are starting to see that, as one pan-European investment manager suggests, “the fundamental demand-supply imbalance is likely to drive rental growth”.

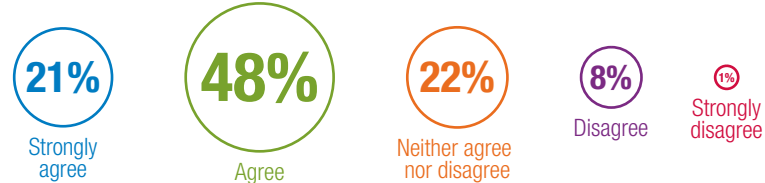
A Dutch pension fund investor says, “Residential is the market where there’s the least balance between supply and demand, and we will try and expand in that. The UK is already a mature market, and on the Continent, it is expanding; we are looking at places ranging from Dublin, Amsterdam, Italy, France and Spain.”

Interviewees in countries as diverse as Austria, Belgium, Czech Republic, Ireland, Luxembourg, The Netherlands, the Nordics and Poland are also drawn to the compelling supply/demand dynamics of rental housing and, in the absence of existing stock, gaining exposure via development. “I know that if we can deliver build-to-rent, there is no end of money that will invest in it,” says one UK adviser.

There are dissenting voices. Some want more government incentives to put build-to-rent returns on a par with build-for-sale, while others are still “struggling with the granularity of the management in the private rented sector”.

But the overwhelming response is positive, and as one specialist housing provider declares: “The tipping point for the institutionalised residential sector has been passed.”

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



Developing strategies

Two-thirds of survey respondents believe redevelopment is the most attractive way to acquire prime assets.

For most, this means a relatively low-risk strategy based on astute asset management and refurbishment rather than a hasty return to speculative development.

However, the interviews reveal that many asset managers and property companies are already assessing development prospects in the context of long-term urbanisation.

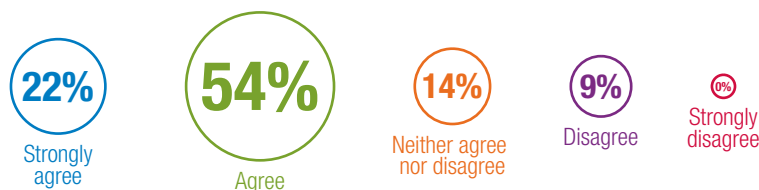
“Infrastructure is the lifeblood of real estate,” says one US developer active in the Eurozone. “Though we haven’t seen it yet, I would predict that in a three-to-five-year period, we’re going to see infrastructure investment unleashed in the US and Europe. We will see trillions of dollars and euros being invested in infrastructure. Those who don’t anticipate that are going to miss something.”

“We will see trillions of dollars and euros being invested in infrastructure. Those who don’t anticipate that are going to miss something.”

Others envisage infrastructure investment and urban regeneration going hand in hand with a 21st century re-boot of an old property concept – mixed-use development. “Many occupiers are looking to create sustainable and secure places to work by offering their employees work-out, restaurant, retail and living options in close proximity,” says a pan-European asset manager. “This will trigger a more mixed-use approach to new developments going forward. Lenders, investors and developers need to work together to deliver this next generation of mixed-use space for more demanding occupiers in future.”

Development may not be an immediate priority for the industry, but as one private equity player points out, there is a pressing need for it in many cities. “We really haven’t had a decent development cycle in Europe since the late 1980s. You have got a lot of 20-plus-year-old buildings that are primed for substantial refurbishment or to be pulled down. That’s going to be an enormously tempting strategy for people to pursue in an environment of tremendously low returns in the fixed-income market.”

Real estate returns will become more difficult to achieve



Smart asset management

Low returns and a lack of product in a late-cycle market have underlined the importance of “smart asset management”.

“We are not going to be able to generate the returns we want by buying assets and sitting on them,” says one pan-European investment manager. “We have to think about the management of the tenants, refurbishment and re-gearing.”

Another global manager concedes: “It’s really going to challenge people like us who have a lot of relative and absolute benchmarks. You’ve got to be very sure that what you’re buying is going to deliver the returns you expect. We are going to be incredibly selective about what we do buy.”

For others, getting smart in a low-yield market means that asset management is increasingly moving into the realm of operational management, and all the risk associated with niche sectors, such as student housing and healthcare.

In such tight market conditions, the greater importance attached to asset management reinforces another trend that has emerged over the past few years – the move by institutional investors towards employing fewer and larger managers.

“For those firms that have a good track record, the capital-raising environment is reasonably strong. But it tapers off dramatically. I think that will continue for a while – just fewer managers getting a greater proportion of the capital,” says one pan-European manager. “But the other key is that if you look at the capital markets and you don’t think there can be a cap rate shift, then we’re back to the ability to create value.”

Another reason why it is “compelling to be large” comes from keeping up with the sheer volume of financial information now required by institutional investors. “Many of the mid-tier players and boutiques are putting themselves up for sale,” says one global manager. “They’re doing it for many reasons, but some of it comes down to all those pressures and the regulatory environment. There will be more consolidation happening in the next 12 months than we’ve seen in a while.”

Others see the need for “better systems, quicker data and more granularity of data” as a key issue well beyond 2018 if real estate is to compete for capital against other asset classes. “The industry really has to get its act together,” says one pan-European investment manager. “Unless we sort ourselves out globally then we won’t get all that capital.”

“If you look at the capital markets and you don’t think there can be a cap rate shift, then we’re back to the ability to create value.”

Co-working takes hold

“As landlords we have to be more flexible,” says one convert to co-working. “Tenants are asking for shorter leases and break options. It requires a change in mindset and a willingness to take more risk.”

The rise of the flexible office sector and co-working stands out in *Emerging Trends Europe*. They are much more than simply property buzzwords but, as the interviews reveal, a workplace phenomenon whose influence has taken hold of the European industry in a profound way since last year’s report.

“Collaboration between tenant and landlord will be more and more crucial,” says one interviewee. “There will be more mobility and intelligent ways to book space. As landlords, we have to cater for that,” says another.

At the very least, co-working and the rapidly changing demands of occupiers are forcing the industry to confront the issue of obsolescence and, as one asset manager suggests, “it will be with the bigger buildings and landlords where the disruptive force is going to be more keenly felt”.

The business model of real estate investors is changing as a result of the move towards “space as a service”



“Not everything is going to be WeWork,” says one value-add investor. “I still think there’s a huge amount of money to be made in traditional offices with larger occupiers. But the proportion of the market will grow for co-working, smaller companies, incubator space. Flexibility within buildings – the ability to sub-divide – becomes increasingly important, which comes back to obsolescence.”

The rise of co-working – tenants as customers – is part of a bigger shift towards property-as-a-service – a movement that appears to be gathering pace and which is analysed in Chapter 4, alongside the impact of social change and technology on real estate.

As many as two-thirds of survey respondents believe that real estate business models and valuations are changing as a result of technology and the move towards space-as-a-service. As one industry leader says: “It’s not a question of if we would like to become more of a service provider than a pure provider of real estate space: we need to.”

“It’s not a question of if we would like to become more of a service provider than a pure provider of real estate space: we need to.”

Chapter 2

Real estate capital markets



The dominant theme for real estate capital markets in 2018 is the tension between the pressure to invest and the fear that real estate is late in the cycle, highly priced and thus carries latent risk.

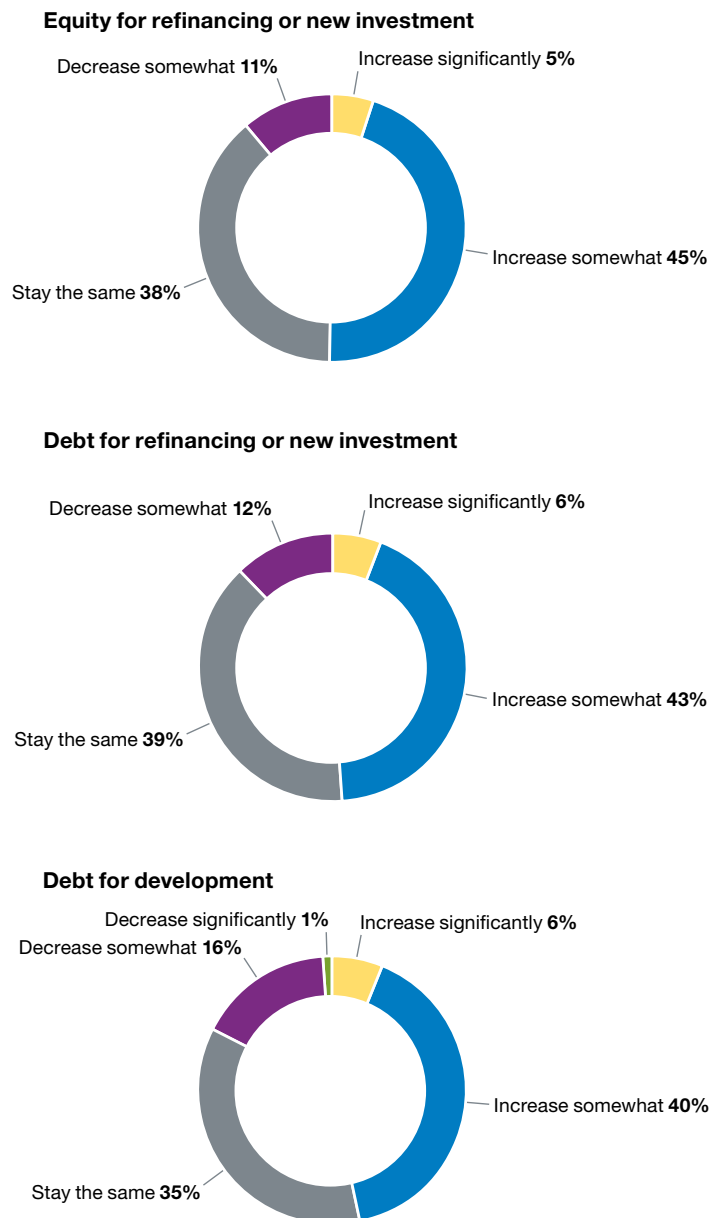
The expectation is that equity and debt will be just as plentiful as in 2017; that most European economies are benign; and that interest rates will not rise fast or far enough to reduce significantly the attractiveness of real estate compared with fixed income. Investment will continue at levels subdued compared to 2015's peak, but high on a historic basis.

But there is still some concern that yields at historic lows are unsustainable, and that it is only the continuation of central bank liquidity programmes that is sustaining real estate pricing levels.

"We're clearly somewhere towards the end of the cycle, and it's foolish to assume that this time it will be any different; it is just when and how we will have a correction," says one global fund manager.

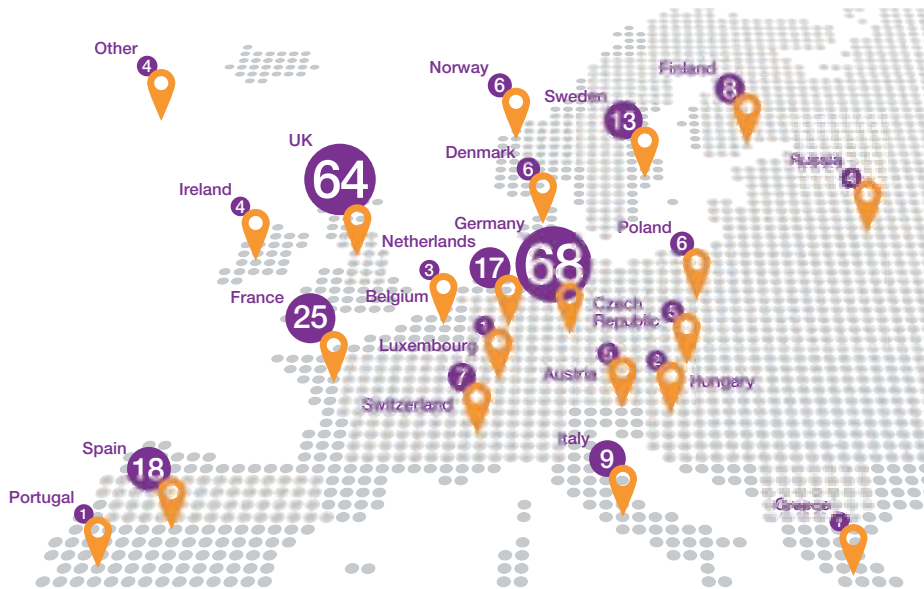
However, there is little expectation that liquidity in debt or equity markets will reduce in 2018 – just 11 percent of survey respondents feel equity availability would decrease, against 50 percent who think it will increase. The figures are very similar for debt, both for investment and development.

Figure 2-1 Availability of equity and debt in 2018



Source: *Emerging Trends Europe* survey 2018

Figure 2-2 Real estate investment in European countries Q4 2016–Q3 2017 (€ bn)



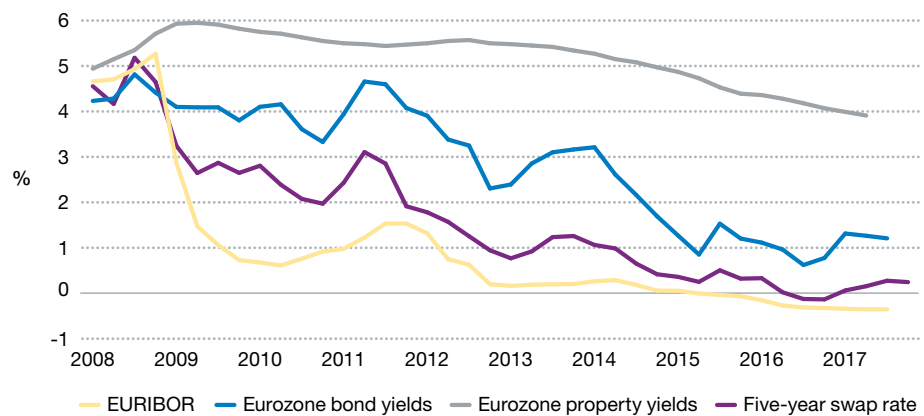
Source: Real Capital Analytics
 Note: Figures are provisional as at 23rd October 2017

European real estate capital markets will remain liquid because of a combination of its relative value compared to fixed-income and underlying economic conditions that are not brilliant, but are broadly favourable for the sector.

“If you feel that equity markets have had their run, you can’t make money in bonds, and money in the bank is negative, then real estate wins by default,” says one pan-European opportunity fund manager.

The continuing low yield of fixed-income instruments is putting pressure on fund managers to invest in real estate, even if they do not feel hugely enthusiastic about this. Among interviewees, there seems to be a greater acceptance than two or three years ago that low yields for core real estate are not going to change any time soon, so they might as well get on with it. “The pressure to invest is still there,” one fund manager says.

Figure 2-3 Eurozone property yields and interest rates, 2008–2017

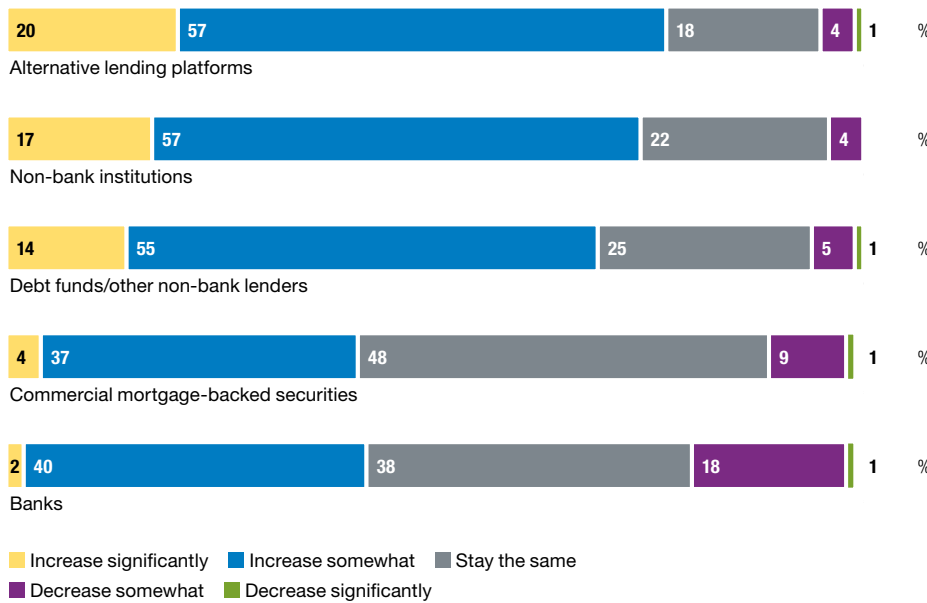


Source: CBRE, Datastream, European Central Bank

“Institutional investors that we are selling to are sitting there and saying, it’s expensive, and what I want to do is sit on the sidelines or sell, but what I’m going to do is invest,” says one global investor. “They’ve got their asset allocators telling them that on a relative basis real estate looks cheap.”

The general consensus is that in core markets like Paris or major German cities yields will not fall further, but that they are unlikely to rise, either. London is something of a special case due to Brexit, and there might be some further yield compression in markets like Madrid and Barcelona.

Figure 2-4 Sources of debt in 2018



Source: Emerging Trends Europe survey 2018

Investment levels will persist as liquidity remains relatively high. “This market has been going up for eight or nine years since 2009, and that keeps us busy but not awake at night,” says one major European pension fund. “We still see plenty of signs that we can continue at these levels – the fact that there is still plenty of equity available chasing property. The spread versus Treasuries is still very healthy, and the sector is not over-leveraged.”

“The beginning of this year really was all about politics but nothing we were worried about materialised, and now you have a situation where every country in the OECD has a growing economy,” says another major European insurance company.

The counter-argument from many interviewees is that prime yields this low are inherently risky. “There is also the risk from generally high prices,” says a European pension fund. “A couple of years ago we were saying we would never see yields reach pre-crisis levels again, and now we are well below them. As long as rates stay low, 3 percent yields look attractive, but in a couple of years we may look at this period as being crazy.”

“As long as rates stay low, 3 percent yields look attractive, but in a couple of years we may look at this period as being crazy.”

Interest rates are the most commonly cited factor that might cause the market to turn. However, there is still a degree of sanguinity about real estate’s ability to deal with anything other than a very sharp and sudden rise in rates.

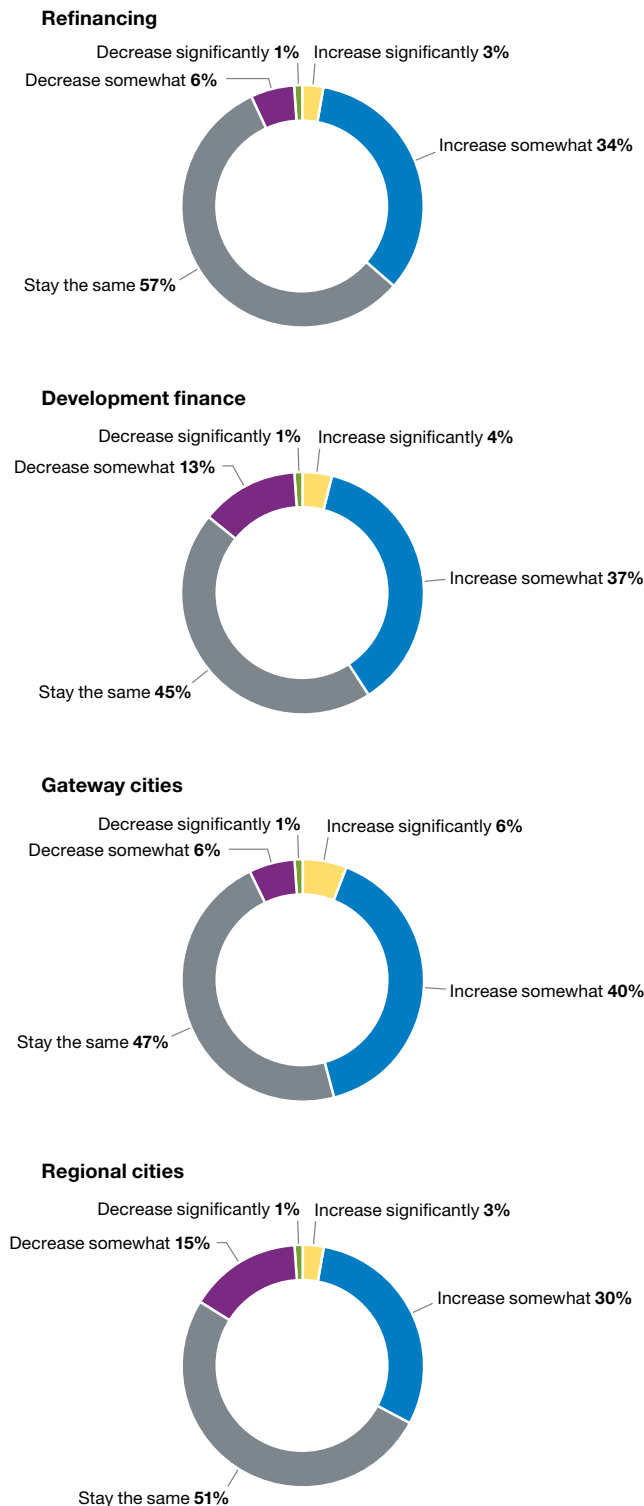
“There is still the room in there to absorb an increase of 100-150 basis points without much of a problem,” says one opportunity fund manager.

Ultimately, the turn in the cycle may just be a “Minsky moment”, as one institutional investor puts it – in other words, when asset values collapse for no other reason than they have moved too far above the norm. “The market is priced to perfection, and it may not be one single thing that causes a correction – but prices have got too hot, and one day, people will just wake up and recognise it’s too expensive.”

In this somewhat uncertain environment, many core investors are increasingly considering providing real estate debt rather than investing in prime assets that may indeed be priced to perfection, especially in markets where you might not be certain of where prices are heading, like the UK. Nearly four-fifths of survey respondents expect non-bank lenders to increase their activity.

“If we buy a building at 3.5 percent yield we cannot assume that in 10 years interest rates will be as low as they are now, and the building will have aged 10 years. Therefore you’ve got to move yield out from 3.5 percent to 4 percent,” says one global fund manager. “Then you’re into negative capital return territory, unless you’re in a market where you think there’s very good long-term growth. And that’s why debt is a good position to take right now; you can generate great income return while protecting your capital and seeing how markets play out.”

Figure 2-5 Access to senior debt in 2018



Source: Emerging Trends Europe survey 2018

Debt remains highly liquid for prime assets, albeit less so for secondary, and lenders claim they are maintaining conservative underwriting standards which means that in theory, it is not posing a systemic risk to real estate this time around.

“We don’t want to compensate for higher risk by taking a higher margin,” says a German banker. “For a while, competitive pressure has been focusing on pricing, but margins have bottomed out now. The temptation is to compete on risk, but that’s a road we don’t want to go down. We accept that we’d rather lose a deal than increase the risk position.”

Just over a third of survey respondents think that there will be more senior debt for investment or refinancing, and only slightly more felt that way about development finance, although interviewees feel speculative development debt is still very rare.

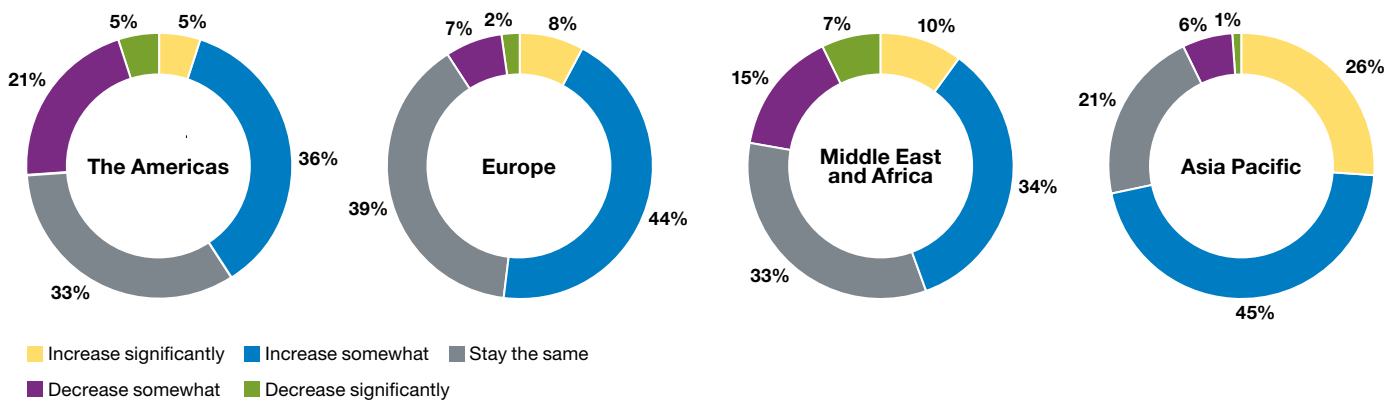
There is also little to choose between senior debt availability for large gateway cities as against regional cities – credit is plentiful across the piste.

“Germany is still massively overbanked, and in France, French banks are being more aggressive,” says one German lender. “I don’t think in general there is any shortage of liquidity. There are gaps in certain markets like development finance in London or hospitality.”

Equity markets exhibit similar patterns, and on a geographic basis, survey respondents are not expecting investors from any part of the world to decrease their investment into European real estate. The strongest increases are expected from Asian and European capital, followed by that from the Americas, with the Middle East and Africa bringing up the rear.

Interviewees agree that a key factor for Asian investors continuing to deploy capital in London offices is the post-Brexit fall in the value of sterling. By contrast, European investors are far less influenced by the currency impact on UK pricing.

Figure 2-6 Cross-border capital into European real estate in 2018



Source: *Emerging Trends Europe* survey 2018

“We are seeing a lot of interest from domestic European investors in their home markets when we are looking to sell,” says a sovereign wealth fund investor. “The French life funds have had huge inflows from retail investors and are doing a lot in Paris, and the Germans are doing a lot in Germany.”

In terms of Asian investors, the outlook is for a large increase in the medium to long-term, but with some short-term bumps in the road as a result of Chinese regulatory intervention (see box).

“You have all of these sovereign wealth funds and superannuation funds that have never even spoken about real estate before, like Japan’s Government Investment Pension Fund, that now want 1-3 percent in real estate; the flows will keep coming from that,” one investor points out.

Much of the interest from the US continues to come from opportunity funds. Record low yields are making it increasingly difficult for them to find high-returning opportunities, but nevertheless they continue to raise capital and try to deploy it.

Chinese clampdown

In 2017, the Chinese government introduced greater scrutiny of real estate deals, a level of regulation which has increased as the year has gone on. It has had an impact, with the Chinese Ministry of Commerce reportedly recording that investment in foreign real estate fell by 82 percent in the first half of 2017.

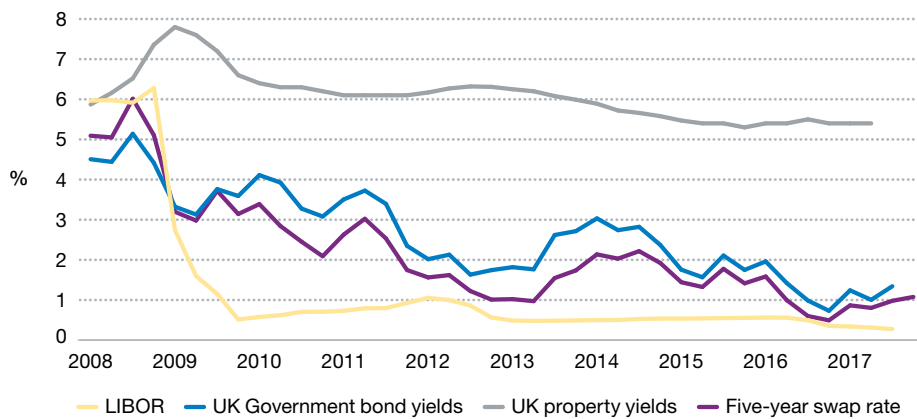
“In China, there is no lack of desire to send capital out, but investment will be more stringently enforced by the government until they have achieved their aims on foreign reserves and exchange rates,” says one Asian investor with deep knowledge of the workings of the Chinese government.

“Approval to undertake deals will take longer. The interest is there but the ability to transact is reduced.”

The investor adds: “China is running itself as one country and one market, and they are making sure foreign deals don’t create a liability for the domestic system.”

The regulation is expected to continue into 2018 before there will be a gradual relaxation.

Figure 2-7 UK property yields and interest rates, 2008–2017



Source: CBRE, Datastream, European Central Bank

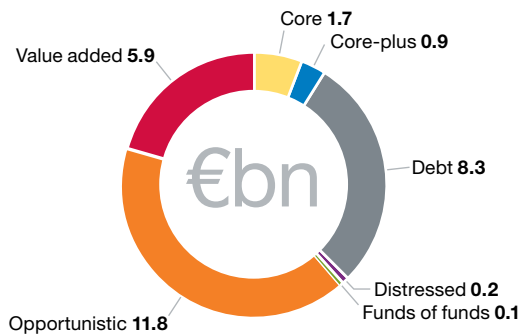
For equity, the big unknown is the UK and Brexit. In the second quarter of 2017, the UK regained its top spot as the biggest investment destination in Europe, according to Real Capital Analytics, as a result of mega deals in London by Asian investors, such as the £1.15 billion purchase of the Leadenhall Building by CC Land.

Beyond these headline transactions the picture is more mixed. “People keep talking about the devaluation of sterling being a good thing, but they must be using a different scorecard to me because as I see it, that means we’re all poorer,” says one global institutional investor.

But others take the opposite view. “We are still positive on the long-term outlook for London. We think it will survive and still rank as a world city in 20 years’ time. We are conservative, but we are currently considering two deals in London, so you can draw your own conclusions from that,” says another global investor.

And one domestic REIT outlines its strategy: “We believe the point of maximum pessimism about the EU exit will be early 2019. If that is the case, we think we will be able to be buying at that point. It will be development sites and short-let buildings in Greater London.”

Figure 2-8 Capital raised by private equity funds for European real estate, Q4 2016-Q3 2017



Source: Preqin

“It’s a tough market to invest in,” one such manager says. “In markets like the UK, you’d like to think there was some potential for bargains on the back of Brexit, but the market is frozen, and anything that isn’t prime just isn’t going up for sale.”

“For the big three – France, Germany and the UK – prices are high, and it has to be a rifle shot, but we are still finding them,” says a manager of a smaller fund.

“We don’t have tens of billions to spend, so we can still pick and choose our spots.”

While few opportunity funds report they are dropping their return requirements significantly, they are more cautious.

“The feeling I get from them is that they are being more location-conscious to try and limit their downside risk,” one banker says. “If they find a deal that is in a great location, they are prepared to give away a bit of return to make sure they don’t get burned if the market turns on them. They are not prepared to take a punt on a lesser location coming good.”

Sectoral shift

After several years near the top of the charts, logistics this year firmly grasps the number one spot in terms of sector preferences. In a world where economic growth is relatively subdued and there are questions around how retail and offices will work in future, the certainty of growth provided by the inexorable rise of e-commerce is proving highly desirable for investors.

“We see it as a hedge against our retail exposure to the extent that if retail suffers, that will be positive for logistics,” one sovereign wealth fund says.

That said, as with retail, there is an expectation that there will be a “squeezed middle” in the logistics sector. “There will be strong ongoing demand for more warehouses, but with what is happening with transport technology and the pressures on fast delivery, the logistics that are in the urban fringe will benefit and so will super-sized distribution centres. The stuff in between will be challenged,” says one fund manager.

Urban logistics – the smaller edge-of-town warehousing which can fulfil the “last mile” of the delivery chain – is cited by many as a growth sector to watch. Previously institutional investors considered it too difficult to manage, but they are now increasingly keen.

“We like the urban logistics space in Europe,” one global money manager says. “We’ve just started doing that in the US, and we could look to migrate this to the UK and Europe.”

Table 2-1 Sector prospects in 2018

| Overall Rank | Investment | Rank | Development | Rank |
|---------------------------------|------------|------|-------------|------|
| 1 Logistics facilities | 4.28 | 1 | 4.21 | 1 |
| 2 Self-storage facilities* | 4.14 | 4 | 4.14 | 2 |
| 3 Private rented residential | 4.15 | 3 | 4.14 | 3 |
| 4 Student housing | 4.14 | 5 | 4.08 | 4 |
| 5 Retirement/assisted living | 4.18 | 2 | 4.04 | 5 |
| 6 Housebuilding for sale | 4.00 | 7 | 4.01 | 6 |
| 7 Shared/serviced offices | 4.01 | 6 | 3.95 | 7 |
| 8 Healthcare | 4.00 | 8 | 3.95 | 8 |
| 9 Serviced apartments | 3.96 | 11 | 3.94 | 10 |
| 10 Data centres* | 4.00 | 9 | 3.79 | 12 |
| 11 Industrial/warehouse | 3.96 | 10 | 3.79 | 11 |
| 12 Affordable housing | 3.80 | 13 | 3.94 | 9 |
| 13 Hotels | 3.92 | 12 | 3.69 | 14 |
| 14 Central city offices | 3.75 | 14 | 3.57 | 15 |
| 15 Social housing | 3.56 | 17 | 3.74 | 13 |
| 16 High street shops | 3.66 | 15 | 3.32 | 17 |
| 17 Parking | 3.52 | 18 | 3.39 | 16 |
| 18 City centre shopping centres | 3.57 | 16 | 3.25 | 18 |
| 19 Science parks* | 3.38 | 19 | 3.19 | 19 |
| 20 Retail parks | 3.34 | 21 | 3.06 | 20 |
| 21 Business parks | 3.32 | 22 | 3.03 | 21 |
| 22 Suburban offices | 3.35 | 20 | 2.97 | 22 |
| 23 Out-of-town shopping centres | 3.03 | 23 | 2.60 | 23 |

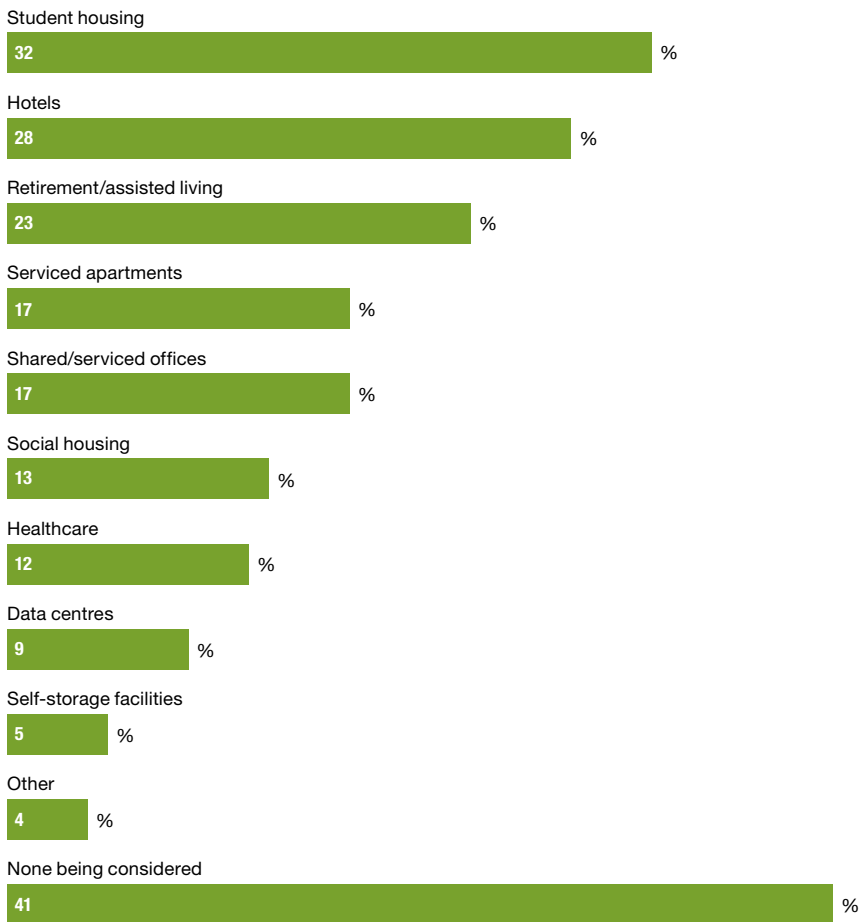
○ Generally good = above 3.5 ○ Fair = 2.5-3.5 ○ Generally poor = under 2.5

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 rank score.

*A significantly lower number of respondents scored this sector

Source: *Emerging Trends Europe* survey 2018

Figure 2-9 Niche sectors being considered in 2018



Source: *Emerging Trends Europe* survey 2018

Note: Respondents could choose more than one category, so percentages do not add up to 100.

After logistics, niche sectors based around various types of residential again dominate the upper echelons of investor preferences. More than half of respondents say they are considering investing in “niche sectors”, principally because of demographic drivers.

Private rented residential and student housing are now seen as firmly established in the UK, and investors and developers are looking to transport strategies to continental Europe, although it will not work on a blanket level.

“Student housing is something that has been big in the UK, and now Ireland. The Netherlands and Germany are seeing that,” says one pension fund manager. “Not so much other markets, there isn’t the same liquidity, but that is an interesting market.”

“Senior living and healthcare are two sectors which should benefit from demographic trends and in which we would like to invest, but there is not so much offer in terms of the right product managed by the right operator,” says one large institutional investor. “It can be a challenge to find the right operating model. They are very regulated and difficult sectors to understand.”

The two traditionally dominant sectors of real estate, retail and office, are undergoing a period of incredible flux, which is borne out in the ranking of investor preferences.

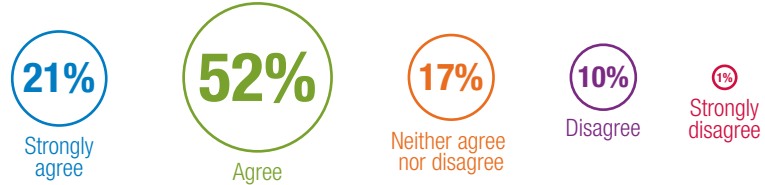
Out-of-town shopping centres rank dead last, with city centre shopping centres only slightly higher, 16th out of 20 sectors. High street retail fares little better at 14th.

The perception of retail has been affected by the flow of heavily negative news from the US: large-scale store closures and huge falls in the share prices of listed shopping centre owners. There is a feeling that although the sector in Europe is structured differently, the omens bode ill.

“In the past three to four months there have been some strong signals from the US. On the pricing side, there have been 15 to 25 percent drops in value, particularly in shopping centres,” says one global investor based in the US. “That is pretty severe when you think about the fact that we are not in the middle of a crisis. I’m not saying it will definitely come here; we know that in the US there is more retail per capita, and the effect of the internet is starting to hit the US now. But it is something you have to take into account.”

“Senior living and healthcare are two sectors which should benefit from demographic trends. But it can be a challenge to find the right operating model.”

Occupiers are willing to pay for shorter leases and increased flexibility



In the office sector, suburban offices and business parks find themselves near the bottom of the pile, as has been the case in recent years. The perception is that they will be left behind by increasing urbanisation.

But shared and serviced offices are having a day in the sun, the seventh most popular sector. This mirrors the recent growth in take-up by flexible office providers – in London, they were the biggest takers of office space in the first half of 2017.

The real estate community is watching this space with interest, and with some scepticism. But in spite of the latter, there is an acceptance that even if the sector does not entirely dislodge traditional offices, it will change them.

“Occupiers are proving more receptive to serviced offices, willing to pay the premium for flexibility,” says one London landlord. “Occupiers have become more demanding on behalf of their staff – the quality of fit-out has improved markedly on London office developments over the past five years.”

The flip side: “There is a lot of capital flowing to the co-working sector, and we are getting towards an oversupply,” says one Asian investor. “You have an asset liability and duration mismatch. You are renting space out for a week or a month but committing to 10 or 20-year leases. I don’t understand the valuations of the largest companies in the sector, other than the fact that there is a tech bubble.”

“Occupiers are proving more receptive to serviced offices, willing to pay the premium for flexibility.”

Chapter 3

Markets to watch



“Germany has been steady state for a long time now. With Berlin, people truly believe it’s going to become a major city.”

Political stability, thriving economies, and cities that “work on being a great city” are what tick the boxes for Europe’s real estate industry. This year, most of its major markets are judged to be doing well.

It is no surprise that German cities take four of the top 10 spots in *Emerging Trends Europe’s* scorecard of prospects this year. Berlin retains its billing as the most desirable city for investment and development in Europe, with Frankfurt and Copenhagen next; Munich and Hamburg are close behind.

“Germany has been steady state for a long time now. With Berlin, people truly believe it’s going to become a major city,” says a pan-European financier.

But it’s a Nordic capital, Copenhagen, that takes the joint silver with Frankfurt this year. Domestic and international players alike are active; there is strong employment growth and a growing tourist trade. Plus, the Danish capital is considered one of the world’s most liveable cities.

Frankfurt, Germany’s financial centre, is starting to see tangible benefits from the UK’s decision to leave the European Union. Some international banks, like Standard Chartered and Nomura, will base their EU headquarters in the city; others, like Citi and Deutsche Bank, plan to beef up their operations there.

Figure 3-1 Europe’s 10 most active markets, Q4 2016–Q3 2017 (bn)



Source: Real Capital Analytics

Note: Figures are provisional as at 23rd October 2017

Table 3-1 Overall prospects, 2018

| Overall Rank | Investment | Rank | Development | Rank |
|----------------|------------|------|-------------|------|
| 1 Berlin | 4.30 | 1 | 4.14 | 1 |
| =2 Copenhagen | 4.13 | =2 | 3.99 | =2 |
| =2 Frankfurt | 4.13 | =2 | 3.99 | =2 |
| 4 Munich | 4.06 | =6 | 3.99 | =2 |
| 5 Madrid | 4.06 | =6 | 3.97 | 5 |
| 6 Hamburg | 4.07 | =4 | 3.93 | 6 |
| 7 Dublin | 4.02 | 8 | 3.90 | 7 |
| 8 Stockholm | 3.97 | =10 | 3.88 | 8 |
| 9 Luxembourg | 4.02 | 9 | 3.80 | 10 |
| 10 Amsterdam | 4.07 | =4 | 3.71 | 14 |
| =11 Barcelona | 3.91 | 13 | 3.81 | 9 |
| =11 Lisbon | 3.97 | =10 | 3.75 | 13 |
| 13 Vienna | 3.91 | 12 | 3.79 | =11 |
| 14 Paris | 3.84 | 14 | 3.79 | =11 |
| 15 Prague | 3.79 | 16 | 3.59 | 16 |
| 16 Oslo | 3.67 | 18 | 3.68 | 15 |
| 17 Milan | 3.74 | 17 | 3.58 | 17 |
| 18 Helsinki | 3.80 | 15 | 3.48 | 18 |
| 19 Budapest | 3.55 | =19 | 3.44 | 19 |
| 20 Manchester | 3.52 | 21 | 3.42 | 20 |
| =21 Birmingham | 3.55 | =19 | 3.34 | =22 |
| =21 Lyon | 3.51 | 22 | 3.38 | 21 |
| 23 Warsaw | 3.42 | 25 | 3.34 | =22 |
| 24 Zurich | 3.44 | 24 | 3.31 | 24 |
| 25 Brussels | 3.50 | 23 | 3.15 | 26 |
| 26 Edinburgh | 3.39 | 26 | 3.20 | 25 |
| 27 London | 3.17 | 27 | 2.89 | =27 |
| 28 Rome | 3.09 | 28 | 2.89 | =27 |
| 29 Athens | 3.08 | 29 | 2.88 | 29 |
| 30 Moscow | 2.89 | 30 | 2.77 | 30 |
| 31 Istanbul | 2.79 | 31 | 2.77 | =30 |

○ Generally good = above 3.5 ○ Fair = 2.5-3.5 ○ Generally poor = under 2.5

Note: Respondents scored cities' prospects on a scale of 1=very poor to 5=excellent and the scores for each city are averages; the overall rank is based on the average of the city's investment and development score.

Source: Emerging Trends Europe survey 2018

Table 3-2 Change expected in rents and capital values in 2018

| | Rents | Capital values |
|---------------|-------|----------------|
| 1 Berlin | 4.09 | 3.90 |
| 2 Hamburg | 3.94 | 3.81 |
| 3 Munich | 3.90 | 3.82 |
| 4 Luxembourg | 3.87 | 3.82 |
| 5 Frankfurt | 3.89 | 3.78 |
| 6 Paris | 3.81 | 3.81 |
| 7 Amsterdam | 3.90 | 3.69 |
| 8 Vienna | 3.72 | 3.84 |
| 9 Copenhagen | 3.65 | 3.69 |
| 10 Madrid | 3.69 | 3.64 |
| 11 Lisbon | 3.62 | 3.63 |
| 12 Dublin | 3.64 | 3.53 |
| 13 Barcelona | 3.55 | 3.59 |
| 14 Milan | 3.52 | 3.55 |
| 15 Prague | 3.42 | 3.58 |
| 16 Oslo | 3.44 | 3.41 |
| 17 Stockholm | 3.39 | 3.46 |
| 18 Birmingham | 3.42 | 3.33 |
| 19 Athens | 3.30 | 3.38 |
| 20 Helsinki | 3.38 | 3.27 |
| 21 Edinburgh | 3.29 | 3.28 |
| 22 Manchester | 3.20 | 3.36 |
| 23 Warsaw | 3.27 | 3.16 |
| 24 Lyon | 3.27 | 3.13 |
| 25 Brussels | 3.05 | 3.33 |
| 26 Rome | 3.07 | 3.19 |
| 27 Budapest | 3.15 | 3.07 |
| 28 Moscow | 2.96 | 2.96 |
| 29 Zurich | 2.79 | 3.12 |
| 30 Istanbul | 2.55 | 2.42 |
| 31 London | 2.39 | 2.45 |

^ Increase — Stay the same v Decrease

Note: Respondents scored the expected change for 2018 compared to 2017 on a scale of 1=decrease substantially to 5=increase substantially and the scores for each city are averages; cities are ranked on the basis of the average of expectations for rents and capital values

Source: Emerging Trends Europe survey 2018

We see strong opportunities in Europe's capital/gateway cities



“The biggest winner from Brexit will be Germany and Frankfurt,” says one interviewee. Some are more sceptical about the scale of Frankfurt’s potential win, but it is always on the list of the continental cities likely to see an influx of firms setting up or enlarging their European operations.

Brexit also underpins Luxembourg’s place in the rankings; it enters at Number 9, the first year *Emerging Trends Europe* has included the Grand Duchy’s capital in its survey. “I am convinced that Luxembourg will benefit from Brexit,” says one local. Stable, business-friendly and already a hub for the European fund management industry, this small market is garnering more attention.

Amsterdam and Dublin, two other European capitals that are in the top 10, are also tipped as Brexit-benefitters. Both are already attracting banks and financial services companies, which are shifting staff, setting up subsidiaries, or moving wholesale. Both have skilled local workforces, English speaking, good infrastructure – Amsterdam’s digital network gets a big tick from trading operations – and have strong reputations as liveable cities: all features prized by the financial sector.

The scores awarded by those canvassed this year indicate they believe Europe’s major cities will have improved investment and development prospects in 2018. For some cities at the bottom of the league table – notably Moscow and Athens – the picture is judged to be considerably brighter. But Europe’s real estate industry is not predicting a major boost in general; on average, the overall prospects’ score for 2018 is only 7 percent higher than last year.

The industry is still taking a dim view of London’s prospects, judging them to be heavily clouded by Brexit. “The biggest damnation in our market at the moment is Brexit as an uncertainty. It’s not fueling growth,” says a UK adviser.

But although *Emerging Trends Europe*’s survey respondents score it a lowly Number 27, in practice, investors – especially Asian ones – appear undeterred. And the message coming through from *Emerging Trends Europe*’s interviewees is similar: “We will continue to invest in core real estate in the UK – especially London,” says a German fund manager.

Europe’s other major gateway, Paris, sits roughly mid-table at Number 14, improving its rating three steps. The electoral success of Emmanuel Macron and his En Marche party has raised hopes for a more business-friendly environment. “France is looking more positive as long as Macron delivers,” says a global fund manager.

The French capital is also bidding to attract firms from Brexit, and its ambitious “Grand Paris” project, which is stimulating urban development and investing heavily in the transport and digital infrastructure, also ticks boxes. However, the high prices in central Paris – described as “nose bleed territory” – are deterring some.

In Southern Europe, Spain’s continued economic recovery is boosting Madrid and Barcelona, both of which are rated more highly this year by *Emerging Trends Europe*’s respondents. Madrid is now Number 5: rents are rising, there are development opportunities, and hopes that the city, too, may profit from Brexit.

However, *Emerging Trends Europe*’s survey and interviews were conducted before the political turmoil surrounding Catalonia’s bid for independence came to a head in October 2017. At the time, Barcelona was also judged to have good prospects, though at Number 11 jointly with Lisbon, once again it sits below Madrid. The political issue of whether Catalonia could in future split from Spain is a long-standing one, but now it is not clear whether the heightened level of uncertainty about Barcelona’s future will deter investors.

“France is looking more positive as long as Macron delivers.”

Figure 3-2 City investment prospects



Lisbon, meanwhile, has slipped down the scorecard this year, to just outside the top 10 at Number 11. Nonetheless, the city is still judged “interesting due to low prices and economic growth”, and Portugal’s government is given credit for being “flexible, creative, advanced on the tech side”.

Italian cities generate less enthusiasm, a reflection of the country’s economic and financial problems. At Number 17, Milan is given a middling prospects score, but it does have some enthusiastic fans, who say that it “has a different story to the rest of Italy”. Rome, in contrast, continues to languish towards the bottom of the table, slipping to Number 28. The election of a mayor from the populist Five Star movement and the city’s reliance on the government and public sector have clearly influenced sentiment here.

Last year’s *Emerging Trends Europe* highlighted the improved rankings for Europe’s smaller capitals and regional centres. This is less evident in this year’s survey; indeed, two of these – Zurich and Lyon – have tumbled precipitously, to Number 24 and joint 21st respectively. However, this does not seem to reflect a drastic U-turn in local fortunes, but rather, there is now much more competition in these markets.

And in the UK, the regional centres of Manchester and Birmingham are ranked better than London, at Numbers 20 and 21 respectively. Less dependent upon financial occupiers and foreign capital, these second-tier cities are now reckoned to offer interesting opportunities at better value than “over-priced” London.

We see strong opportunities in Europe’s second tier/regional cities



In contrast, Scotland’s capital, Edinburgh, is less well-rated at Number 27. Political uncertainties, namely Brexit and the likelihood or not of a second referendum on Scottish independence, are dampening the city’s appeal.

Views on Central European cities are mixed. Prague is the most-favoured, improving its rank four places to Number 15. A robust economy, tourism and active domestic investors underpin this ranking. Budapest comes somewhat lower down, but the political concerns that were voiced last year are less in evidence, and this “under-estimated” market is back on the radar.

Warsaw, the laggard in this group, is at Number 23. While the size and health of Poland’s economy are a big plus, political uncertainty, concern about possible tax changes and Warsaw’s bloated development pipeline are currently making investors nervous.

Athens, Moscow and Istanbul remain at the bottom of *Emerging Trends Europe’s* prospects league. Here, weak economies and politics are deterring all but the bravest foreign investors. But though they are lowly rated in comparison with the other major European centres, none of these cities scored as having very poor prospects this year.

“Greece has done some things right in terms of the bitter pill it had to swallow.”

Regarding Athens, “there is a sense of recovery and that Greece has done some things right in terms of the bitter pill it had to swallow,” says a global investor/developer. Indeed, some opportunistic investors are starting to scent the bottom of the market: fears of a default and Grexit have ebbed, tourism is booming, and yields are attractive.

And in Moscow, local players are also calling the market’s turn, saying yields will start to compress. “You can buy quality assets at near replacement cost.” Although sanctions are still biting, Russia’s GDP growth is heading up and inflation is falling, “It is definitely feeling a lot better in Russia,” says an international investor/developer.

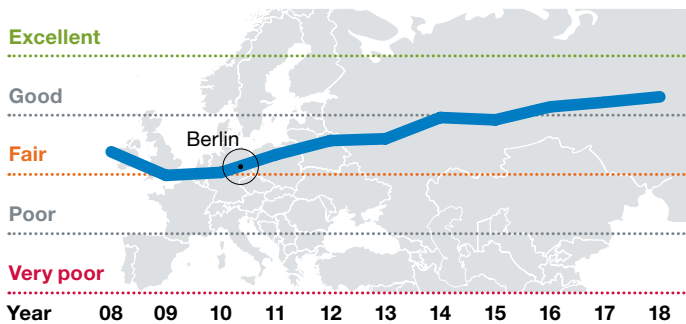
But for Istanbul, political instability in Turkey has taken its toll. The economic consequences of the recent turmoil – outflows of foreign capital, rising inflation, currency volatility – are hitting the real estate market. International investors are steering clear or pulling out, but domestic ones see population growth, the demand for housing and the need to build better-quality stock as opportunities.

The cities

Emerging Trends Europe ranks the real estate markets in major European cities according to their overall investment and development prospects, as shown in Table 3-1. In this section the number in parentheses shows the city's 2018 overall ranking, while the graphs track its investment prospects over 10 years. The population, employment and disposable income per capita forecasts for the metropolitan areas in 2018 by Moody's Analytics are also shown, as is the annual change in these over the past decade. Where available, MSCI's all-property returns for each city over 2008-2016 are also included.

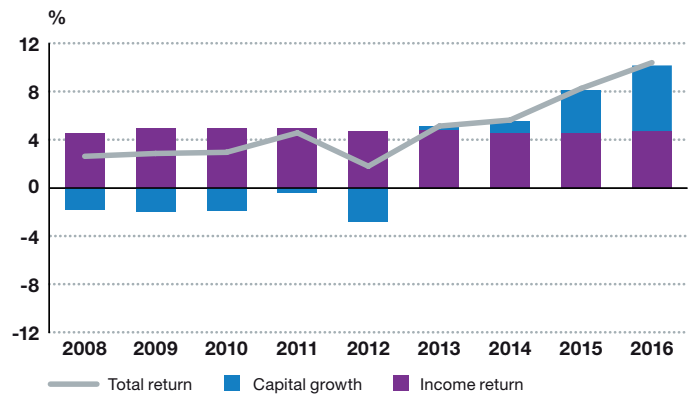
Berlin (1)

Investment prospects, 2008–2018



Source: *Emerging Trends Europe* survey 2018

All-property return, 2008–2016



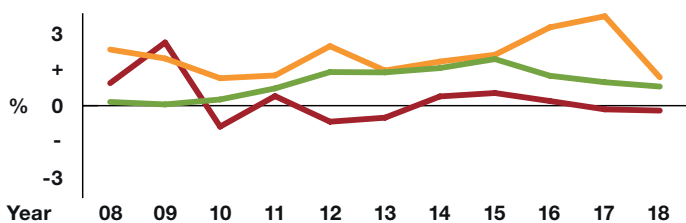
Source: MSCI

Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

“Fantastic”, “thriving”, “the hottest market in Europe”. *Emerging Trends Europe*'s interviewees crown Berlin their Number 1 investment destination for the fourth year in succession. Prices have rocketed, and interviewees observe yields as low as 3 percent for office and retail property. “It is the most expensive German city, according to yield levels – even more expensive than Munich – something that never happened in the past.”

The cornerstone of the German capital's appeal is that while values are high in all of the main European cities, in Berlin they are widely considered to be sustainable, buoyed by rapid population growth and vigorous business expansion, with the technology sector at its forefront.

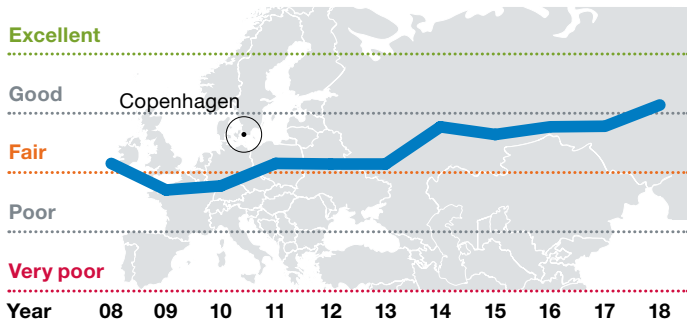
An international pension fund investor says: “We like cities like Frankfurt and Munich, but they are expensive. Berlin on a cost basis and future upside basis has got the most to offer. Real pricing is materially below other world cities. It's got an educated work force, creative people and culture, as well as the government sector and the benefits that brings.”

However, scope for further capital growth is limited: “If you look at yield levels, they are the same as Paris and below Munich and London's West End, so there is not much room for that to compress going forward.”

Investors are betting on rental growth, however: “It is very hard for tenants to find space, and rents are going up quite fast. We sold an asset there that had doubled in price in five years. You cannot consider it to be overheated because there is so much demand from tenants.”

Copenhagen (=2)

Investment prospects, 2008–2018



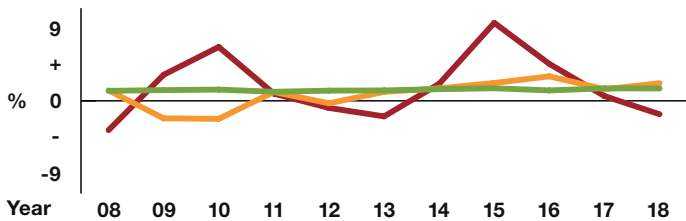
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



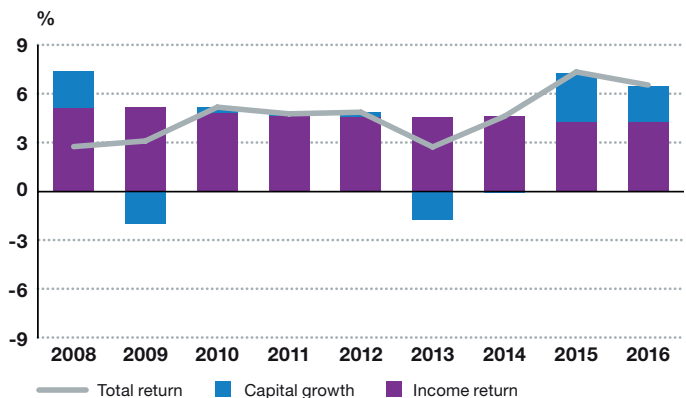
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

The residential opportunity may explain Copenhagen's high, joint second position in the *Emerging Trends Europe* leader board. Residential investment in Copenhagen has rebounded on the back of strong employment growth as the country's economic recovery gains pace. Fed by Denmark's very low (negative) krone interest rate and continuing urbanisation, prices for flats in Copenhagen are now above pre-crash levels.

Investors are interested in all types of residential in the city, from senior living to student housing and everything in between. Student housing is tipped as a sector to watch as it barely exists yet as an asset class here.

"The flow of capital into Denmark this year has increased significantly, very much in the residential market", says one Nordics specialist. "Swedish and some Norwegian players have been searching for residential portfolios and development projects." Multifamily transaction volumes doubled in the first half of 2017 and accounted for the fact that 80 percent of all buyers were from outside Denmark.

But the greater Copenhagen area has plenty of other attractions for investors too. Denmark's attractive capital is popular with tourists, consumers, retail, and food and beverage brands. "There is a mega-trend in the Nordics: travelling," says one respondent. "Today people travel more, and they eat better," adds the Nordics' head at a pan-European fund manager.

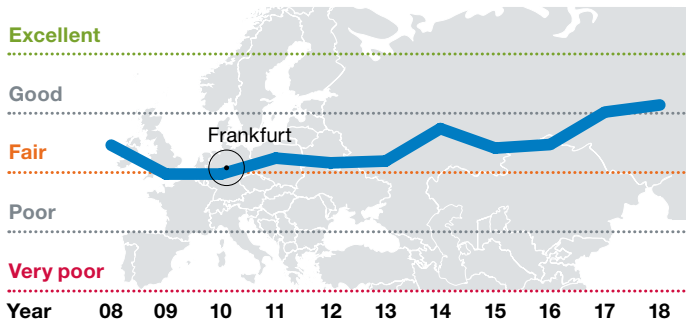
Copenhagen airport's passenger flow last year was 29 million, and it plans to expand to handle 40 million in the next few years. A string of hotel deals this year includes the airport's tie-up with Nordic Choice, one of Scandinavia's largest chains, to develop a new hotel and conference centre there. The number of investors prepared to put in the work to understand the sector is increasing, says one adviser: "The outlook for rental growth for hotels, assuming you have the right product in the right location, is very interesting."

The city also figures on the lists of co-working companies looking to expand internationally, while the country's logistics market is "the second most interesting after Sweden", according to a regional logistics specialist.

Net initial yields for logistics are higher than in Norway or Sweden, while vacancy and new supply is low. Nordic countries are in the top 10 in terms of percentage of individuals who buy regularly online: notably Denmark holds the second position, with 83 percent.

Frankfurt (=2)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

“The biggest winners from Brexit will be Germany and Frankfurt.” This view is shared by a large number of *Emerging Trends Europe*’s interviewees this year and goes a long way towards explaining the German financial capital’s rise to Number 2.

The Association of Foreign Banks in Germany estimates that between 3,000 and 5,000 new jobs will be created in Frankfurt over the next two years as a result of Brexit. Four banks, Citigroup, Morgan Stanley, Nomura Holdings and Standard Chartered, have already selected the German city for their EU headquarters to protect their continued access to the single market. UBS is believed to be considering a similar move, and Goldman Sachs has leased space as part of its Brexit contingency plans.

“Frankfurt always had a solid international base of occupiers, but that has been picking up. There is a big Brexit effect on Frankfurt. You can see it in the investment market and the occupier market as well,” says a German fund manager.

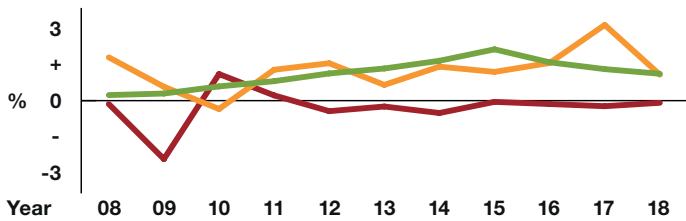
The city has seen a surge of investment activity. In the first six months of 2017, €2.8 billion of real estate changed hands, €2 billion in the second quarter alone. Meanwhile, office vacancy levels have reduced, and the supply of new unlet space scheduled to be completed in the central business district is low, leading to fears that Frankfurt may not be able to cash in on its Brexit bonanza.

Population, employment and disposable income per capita, 2018



Source: Moody’s Analytics

Population, employment and disposable income per capita, annual change 2008–2018

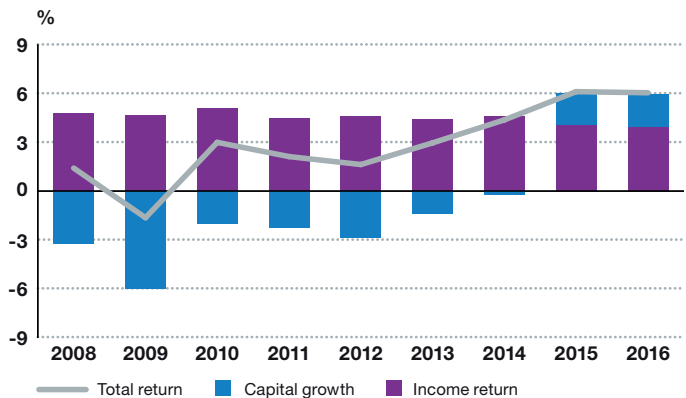


Source: Moody’s Analytics

Speculative office development has been considered a hazardous enterprise in recent years because of relatively high vacancy rates and restructuring in the German banking sector that has stifled demand. Attitudes may be changing, however.

“Development in Frankfurt is probably coming online a little bit late, but the Brexit relocations will give developers a bit more confidence in terms of early pre-leases,” argues a German investor. “Building speculatively in Frankfurt is the highest risk we have taken, but we see rents being stable at a high level compared with recent years, and we are building assets that don’t have to have the highest rents in the market,” adds a developer with ongoing projects in the city.

All-property return, 2008–2016

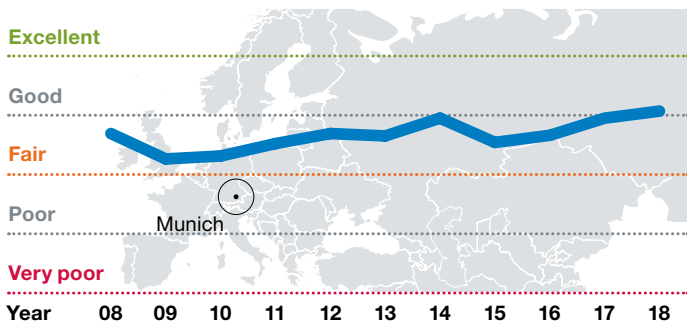


Source: MSCI

Some doubters are still unconvinced that the Brexit effect will fulfil expectations, however: “Small groups of people are going to places like Frankfurt or Amsterdam, but I don’t see a huge exodus from London and certainly not heading to one place like Frankfurt or Paris and having a huge effect on that city,” says a pan-European investor.

Munich (4)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

Munich is near the top of many investors' wish lists again this year, but there is widespread head-scratching about how to carve out a chunk of one of Europe's dearest markets.

A big German fund manager says: "All the German cities are sound, diversified markets. The problem is pricing. Munich is going crazy, and we are still looking for our niche. We like these core cities, but for transactions like forward-fundings."

Managing to core is an increasingly popular approach: "In the German cities – Berlin and Munich – the opportunity is more about the fundamental drivers and in the case of Munich a lack of stock. Our strategy is less about investing in existing core assets and more about finding a way to deliver product that is core when we complete our business plan," says an institutional investor.

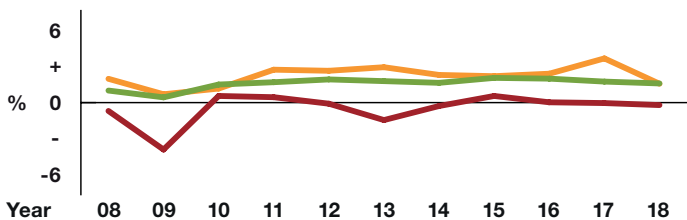
Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

The city's office vacancy rate halfway through 2017 was a rock-bottom 4 percent, which has encouraged those investors lucky or far-sighted enough to own sites to bring forward development. "Prime land in Munich is already built on, so we are building in the areas in the next tier down. We see rents rising there as well. Our land bank there contains a lot of residential, and we have changed our strategy to build that too."

Population, employment and disposable income per capita, annual change 2008–2018

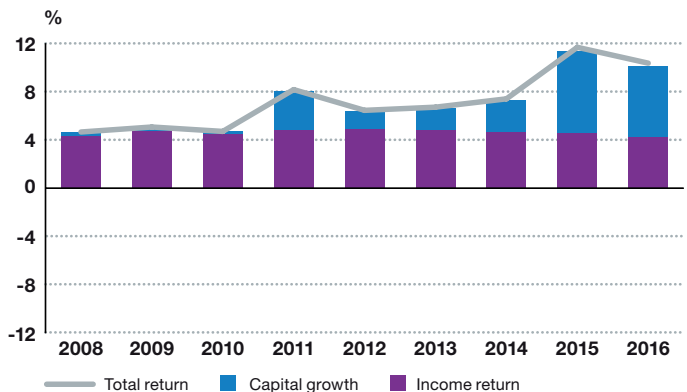


Source: Moody's Analytics

There are some dissenting voices. Yields have come in to around 3 percent for prime offices, and core retail investments can be even more keenly-priced at 2.9 percent. "Too expensive," says one interviewee. "Over-priced," is the verdict of another. "Increasing costs in Munich could become a disadvantage for the city because of the high cost of living and scarcity of space," warns a third.

However, tenant demand remains vigorous in a city favoured for its diverse occupier base and near-full employment. When that is combined with a limited supply of new space in the centre, some investors are counting on strong rental increases. "Munich is pricey if you don't think it has growth prospects. We believe we have significant rental growth potential in the offices we have bought there recently, so a low headline yield makes more sense."

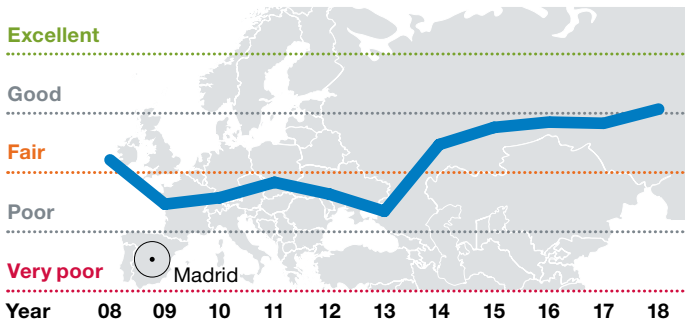
All-property return, 2008–2016



Source: MSCI

Madrid (5)

Investment prospects, 2008–2018



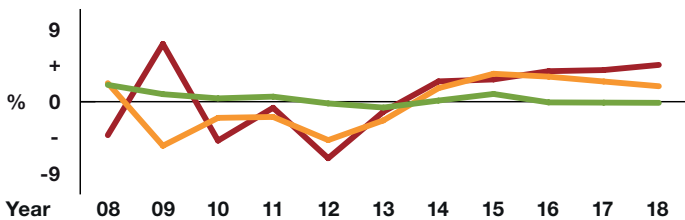
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



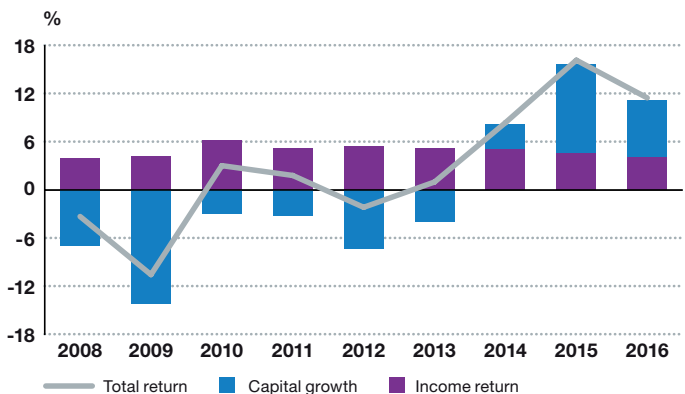
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Madrid's substantial office market is in transition – after a cycle of yield compression, office rental growth is finally starting to come through.

Respondents cite plenty of other reasons to invest in Spain, but the capital's rental growth story is this year's biggest change and arguably the most attractive opportunity. It explains why Madrid jumps four places to feature in the top five.

"The increase in prices in the last two years has been due to the expectation of rental growth, which hadn't materialised and is now starting to; that should lead to some increase in value, and buyers who had backed off a bit might start to get more aggressive again," says an opportunistic fund manager.

"We have seen yields tick down in the last six months as the political uncertainty on the continent has dissipated," chimes a global fund manager. "They will stay at those levels, so then it becomes a question of rental growth. We are in a positive rent cycle, and Madrid is very early in that cycle so there is scope to make money off these very low cap rates."

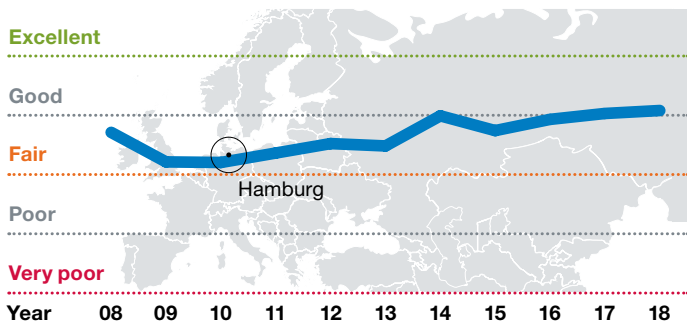
Compared to European capitals further north, rental growth has been held back by the hit the Spanish economy took after the global financial crash; unemployment has been falling steadily but is still around 17 percent. Sareb, Spain's bad bank, sits on €82 billion of sour property loans and only sold €1.5 billion-worth last year - implying a 54-year backlog if it does not speed up. But at least this inventory is no longer on the books of the banks, many of which are lending again.

The country's recovery is now going at full speed and is one of the fastest-growing in Europe. Spain's GDP growth is impressive – 3 percent last year and expected to be similar this year and next. The 2017 real estate investment volumes are on course to surpass the historic peak with some large portfolios on the market, and there are buyers of every stripe for retail and hotels as well as for opportunities to capture rental growth in the city's office CBD and office and logistics submarkets.

Student housing is sought after, but with the only two Spanish portfolios of scale, Resa and Nexo just traded, would-be investors will have to be prepared to develop. It is a similar picture for other operational assets as well as for city centre residential; the latter is undersupplied and is enticing an increasing number of investors, both domestic and international.

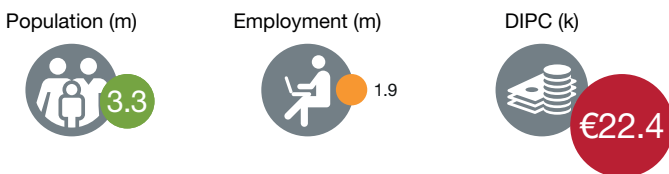
Hamburg (6)

Investment prospects, 2008–2018



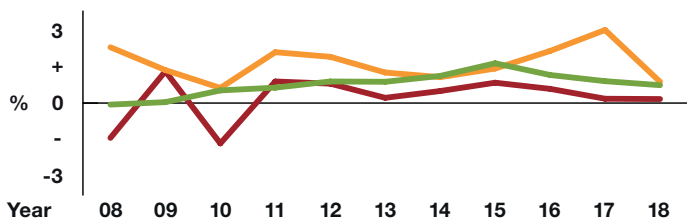
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



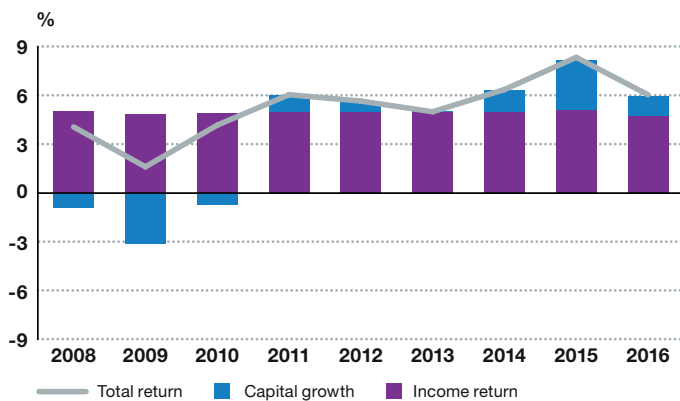
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Could Hamburg be losing some of its sheen? Ranked second for its prospects in 2016 and 2017, Germany's fourth-largest property investment market drops to Number 6 this year.

Sky-high prices may be deterring some investors. Prime office yields have compressed to 3.25 percent. "Munich and Hamburg are difficult markets due to the combination of high rents and low yields," comments a German asset manager.

Interviewees point out that driving returns in the German cities is tougher than ever: "In order to play in these markets you need to adjust your expectations downwards or be priced out altogether." Others are looking to cash out: "Given what we've seen with capital growth in German cities over the last three to five years, you have to take profits and think about where to reinvest the money – that is the big challenge."

Around €1.3 billion of real estate was traded in Hamburg in the first half of 2017, 34 percent lower than the figure for the same period the previous year. However, that is due to a scarcity of property for sale rather than weakening demand; many interviewees still put Hamburg near the top of their list of targets. "The top seven German cities offer the best opportunities in 2018, especially Berlin and Hamburg," is a typical comment.

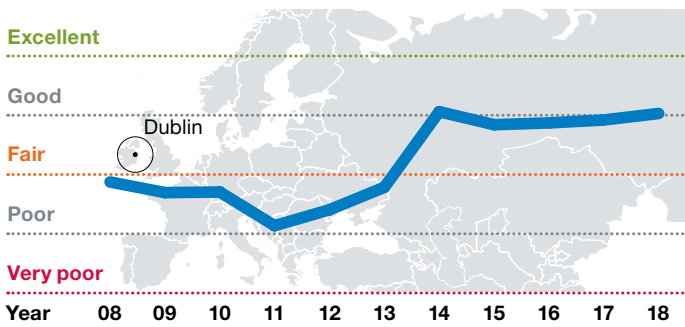
Trends in the international market have played their part: "Germany has been a big beneficiary in that London is no longer as globally popular as the core market. You're seeing a positive impact on the major European core markets – Hamburg, Berlin, Munich, Frankfurt, Paris – but weaker capital flows in the UK."

Meanwhile there are also local factors at play: "Hamburg might be joining Berlin and Munich in its development because its image has improved. The new opera house has added something to that, and it is becoming more fashionable for certain industries," says a German investor.

Hamburg's office market has proved particularly attractive to investors, accounting for almost 70 percent of the market in the first six months of 2017. Take-up has been strong, and demand from buyers has been underpinned by the expectation of further rental growth, leading to rapid yield compression in fringe sub-markets as well as the city's core.

Dublin (7)

Investment prospects, 2008–2018



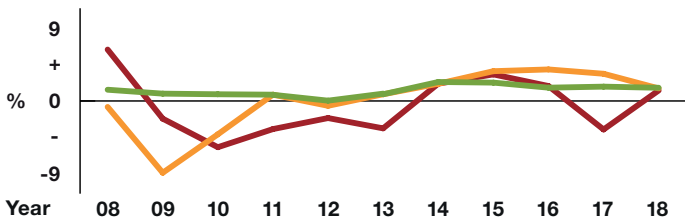
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



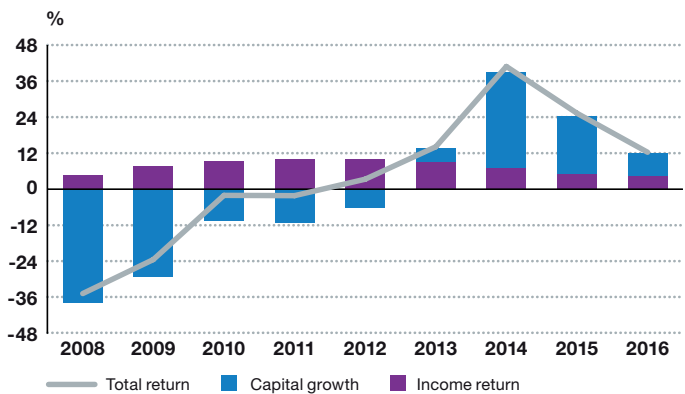
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Dublin is settling into a new phase as a normalised, safe market to invest in after years as an opportunistic investing story. The make-up of buyers is changing accordingly: less US private equity capital and much more institutional money, largely from Europe, especially from Germany, France, Switzerland and the UK.

Fueled by consistently strong Irish economic growth, the capital's property markets are "close to fully recovered", according to one long-term investor there. Most of the yield compression has happened already, with prime offices priced at yields of 4.5-5 percent and rents at €590-€645 per square metre per annum.

Investors see it as a good location for stable income; tenant demand from growing companies is healthy. The city has developed strong niches in financial services, US tech companies and aviation leasing, and its airport is exceptionally well-connected to the UK and US.

Dublin is also universally viewed as one of the cities likely to benefit from Brexit. JP Morgan buying a 9,290 square metres office building for its occupation "is a signal", says one interviewee. With a relatively small office market of 280-370,000 square metres, "it doesn't take a lot to move the dial", says another. "Brexit will add another few years to demand for commercial property in Ireland," believes a third.

However, there is still some concern about potential negative effects if the UK were to go into recession as a result of Brexit, particularly on Irish tourism.

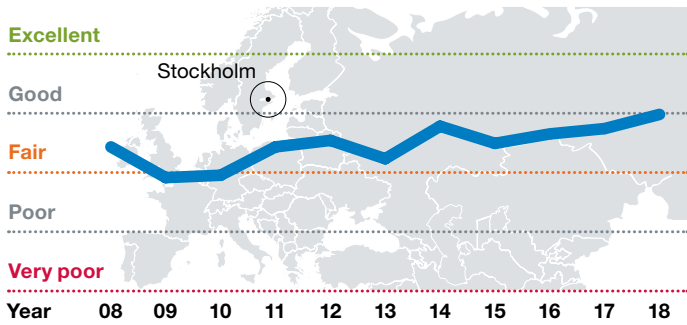
The other risk for Dublin is that the city's infrastructure will not keep pace with its growth. It has had seven years of almost no domestic investment in new infrastructure and education, and projects like the Metro North, which would serve the airport, have yet to materialise. The city needs much more housing, and respondents see the private rented sector and student housing as a huge opportunity in the next three to five years.

As elsewhere, retail is a hot topic. Dublin city centre high street, and dominant shopping centres and retail parks, have been targets for big investors in the last two years. But some of the major brands in other European capitals, like Apple or Nike, do not go there.

"We're an island, and for better or worse the population is too small to attract them," says one Irish interviewee, "so people buy online, and online is getting better and easier." His company is switching out of shopping centres and will develop more logistics – now very viable, as rents for quality assets have doubled to €97-€108 per square metre per annum since the crisis.

Stockholm (8)

Investment prospects, 2008–2018



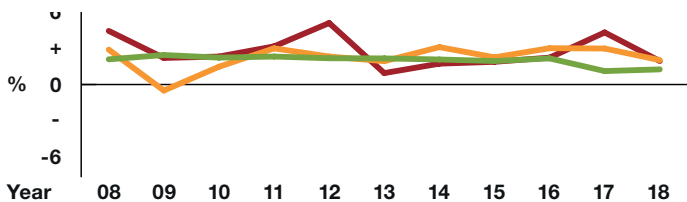
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



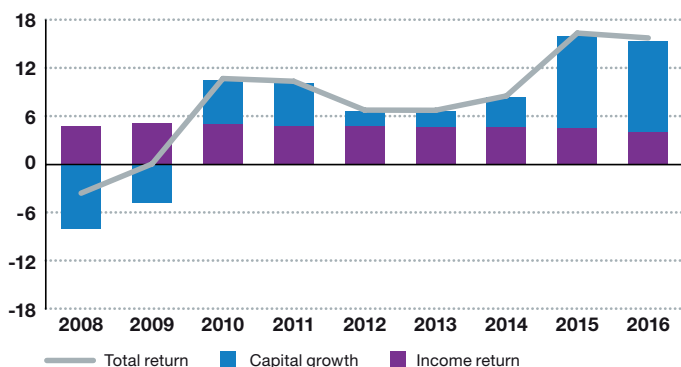
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Stockholm's investment market continues to be one of the busiest and most liquid in Europe, with cross-border players competing to buy against Sweden's deep bench of sophisticated local property companies and fund managers.

The biggest economy in a politically stable region, Sweden benefits from one of Europe's fastest-growing populations due to urbanisation and a flow of refugees and migrants, many of whom are well-educated and young. Its capital city is seen as a place that constantly invests in its infrastructure and gets things done.

Record levels of investment for the last three years means Stockholm's CBD prime office yields are as low as 3.5 percent, the best shopping centres, 4 percent, and logistics 5.5 percent, Savills says. Respondents expect yields will now stabilise, with rental growth the driver for future outperformance.

Some of the best opportunities lie in locations around the city centre. "There's a new ring road being constructed in Stockholm which will change the dynamics of the suburban market, and there are also new tramways being built which will connect suburban areas. Those markets are interesting," says one local value-add fund manager.

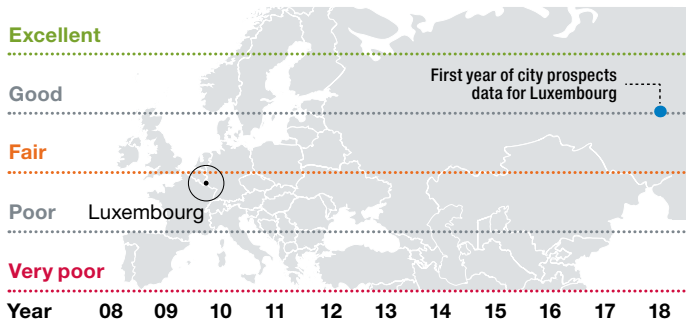
Most municipalities around Stockholm are expanding. Several of the larger development areas allow for mixed use like Hagastaden on the border between Stockholm and Solna, Huddinges Flemingsbergsdalen in the south, Järfälla Barkarbystaden in the north and Nacka in the east. The Stockholm New Creative Business Spaces programme in Hammarby Sjostad area plans to deliver 100,000 square metres of offices. "Tenants are moving to the strong clusters with good local facilities," says a fund manager – especially if their staff live nearby. The head of a global private equity firm says it is a "Silicon Valley" model and compares Stockholm to Seattle.

Housing supply has not kept up with demand, though that is changing, with a lot of product coming to market in the next two years. Like London and Frankfurt, Stockholm is moving towards smaller units and denser schemes, and a widely-voiced concern is that more of it should be at affordable prices.

Some local investors do not think the country's -0.5 percent negative interest rate combined with 2-3 percent GDP growth is sustainable and hope for a rise in rates rather than slowing growth. Another uncertainty, especially for developers, is next year's proposed tax reform – the government wants to increase the country's tax-take and is targeting real estate to do it.

Luxembourg (9)

Investment prospects, 2008–2018



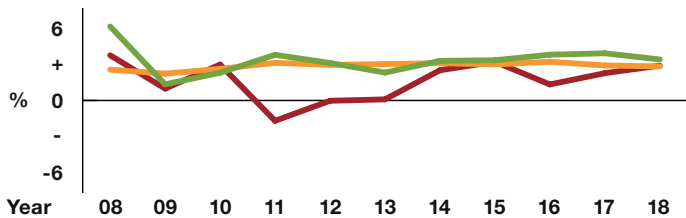
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

Note: National level data is used for Luxembourg.

All-property return, 2008–2016

MSCI does not produce an index for Luxembourg.

Nobody doubts that the Grand Duchy of Luxembourg will be anything but stronger as a result of Brexit, making it timely to introduce its city to *Emerging Trends Europe*, where it enters in ninth spot.

“We see a clear opportunity for us and Luxembourg because of Brexit, as the city is a hub for distribution of investment products within Europe and worldwide,” says a fund administrator.

Cross-border investors share this view, and some say the ripples are already spreading: “We see Luxembourg as a very attractive alternative for London. You can already see increasing construction activity there since the Brexit vote,” comments a Swiss investor. “There is not a lot of tangible evidence of Brexit’s impact on the markets we play in – except in Luxembourg,” says the head of real estate at a European insurance group.

In addition to its strong financial sector, the country is also growing its economy with major investments in industrial sites, data centres and logistics.

A downside is that this city of 575,000 people is expensive to live in; another concern is that there are possible issues with infrastructure, because there may not be enough residential, retail and schools planned to accommodate an influx of new businesses.

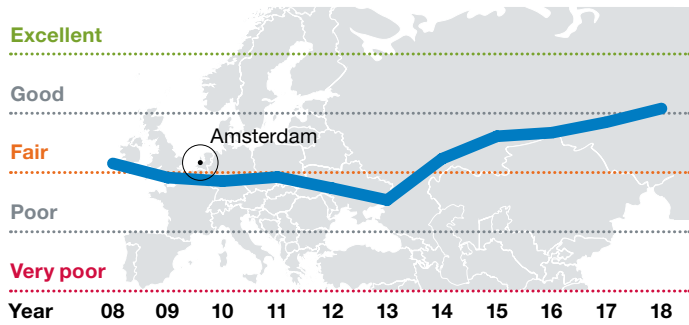
Luxembourg is also hard to place capital into for real estate investors. Yields are low for a small market, but “they are supported by the trend of the economy and the tight market”, says a fund manager.

With GDP growth of 4 percent, pro-business officials and a professional and transparent market, more and more international firms are willing to invest. “With or without Brexit, the city is a platform for the financial industry that is considered an entry point to Europe for a lot of investors,” says the fund manager.

So, yields could compress further. The best buildings in prime districts like Kirchberg or Cloche d’Or are priced at 4.35 percent and in secondary locations in the suburbs, 5-6.75 percent. Rents are €600 per square metre per annum for the very best new buildings, compared with €300–€324 per square metre per annum further out.

Amsterdam (10)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

Amsterdam is one of the last of Europe’s core cities to turn around after the financial crisis, but turn around it certainly has.

The oversupply of office space in the metropolitan area has gradually reduced to a vacancy rate below 10 percent, says CBRE. In a few prime districts, such as the Zuidas (South Axis), there is hardly anything to rent.

Rapid office yield compression has continued in 2017, to almost 4 percent. However, investors see opportunities for further falls in the greater Amsterdam area, as rents are rising faster than most other European cities except for Madrid and Barcelona. Unsurprisingly the Dutch capital has moved up one spot to take its place as a top 10 city.

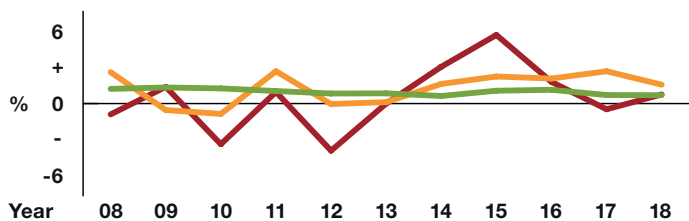
Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

“There is an interesting technology scene in Amsterdam which means a lot of young and innovative people,” says a large institutional investor. Media and technology firms and serviced offices are the main drivers of demand, and a handful of financial companies have announced that Amsterdam is their preferred base for their Brexit contingency planning: Royal Bank of Scotland and several Japanese banks, plus a number of financial market traders. Many interviewees believe there is much more to come from Brexit: “Amsterdam has the infrastructure and is a great, multinational place to live,” says one.

Population, employment and disposable income per capita, annual change 2008–2018

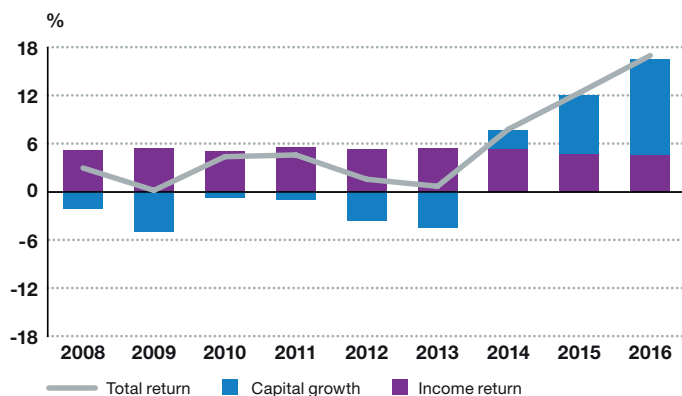


Source: Moody's Analytics

The result of the general election this year, which returned the centre-right VVD party for another term, also stimulated confidence; Amsterdam is attracting both core institutional capital from Europe and Asia and private equity firms buying large and small office buildings with vacancy and re-gearing angles, and hotels. The backlog of suburban buildings with vacancy is also being cleared via conversion to residential.

The city and developers are looking at new locations for expansion. A new north-south metro line is due to open next year with a huge congress centre and residential scheme planned near it on the north side of the IJ river, which should further boost visitor numbers.

All-property return, 2008–2016



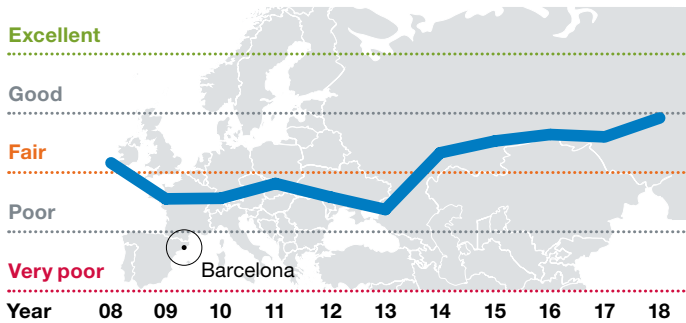
Source: MSCI

But residential affordability is a huge issue: “The housing market is a risk, and the biggest problems are availability and affordability of houses in Amsterdam and other large cities,” says a Dutch expert. To address this, in June 2017 the Amsterdam city government introduced Woonagenda 2025, an ambitious strategy to require that all new residential developments include 40 percent social housing, 40 per cent affordable housing and 20 percent market rate. While this is a radical proposal, it is already impacting future development plans, with prominent projects already committing to achieve the 40-40-20 target.

Prices for industrial and retail have also not fully recovered to pre-crash levels making the city potentially relatively better value than others. However, while logistics in the wider Randstad area is booming on the back of the country’s ports and convenient geographic location, the outlook for retail is patchy.

Barcelona (=11)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

Sitting just outside *Emerging Trends Europe's* top 10, Barcelona has moved up five places, despite political upheaval over Catalonia's independence aspirations.

Most of Spain's real estate community is concerned by the political instability that flared up in October 2017, which has seen Caixa Bank, Spain's third largest bank, and Sabadell, Catalonia's second-largest bank, decide to move their legal headquarters outside the region.

However, what comes through in *Emerging Trends Europe's* interviews, which were conducted before October, was that the situation was not turning investors off.

"Investors are applying a practically zero political risk, as they do not believe that Catalonia will be independent," says one Spanish CEO. "We haven't seen any negative effects on rent or take-up, nor in opportunities to invest from owners divesting in Barcelona," agrees a second.

It would be a pity if it did, for along with arch-rival Madrid, Barcelona is viewed as one of the European cities best-placed for strong growth, including potentially benefiting from Brexit. It threw its hat into the ring to host the European Medicines Agency, although there are other contenders.

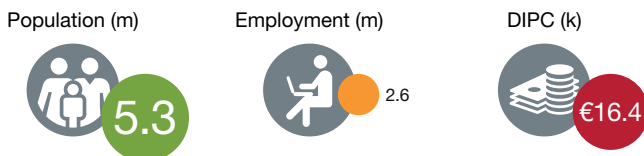
The city has a young population, strong co-working culture and a broad occupier base – star tech companies Tesla and Amazon are here, Tesla with its Spanish headquarters and Amazon setting up hubs for research and development, and to support sellers in Southern Europe. As in the capital, investors are hunting for buildings with letting risk to refurbish and even develop. "Barcelona and Madrid are two markets that stand out," one international adviser says.

There is great demand from retailers, and there are several mixed-use schemes proposed incorporating retail and office or residential, while shopping centre giant Unibail-Rodamco is redeveloping and extending Glòries, one of Barcelona's largest malls.

Hospitality is a sector where opportunistic investors see good value when other sub-sectors now seem quite expensive, while the moratorium on building new hotels introduced by city politicians means it is an attractive time to buy. Tourism is booming across Spain, but according to the Iberian specialist at one private equity fund, Barcelona is special: "It benefits from strong business expansion as well as very strong tourism, and it also has a lot of conference business as well."

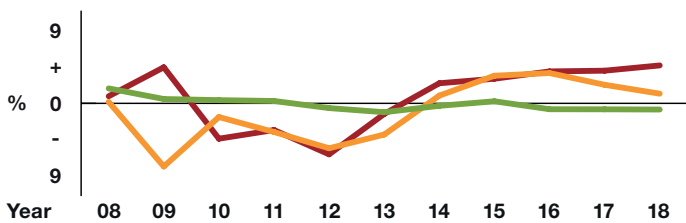
Driven by demand from e-commerce firms, investor-developers are buying logistics sites and speculatively developing new space in the Barcelona region again, for the first time since the global financial crash.

Population, employment and disposable income per capita, 2018



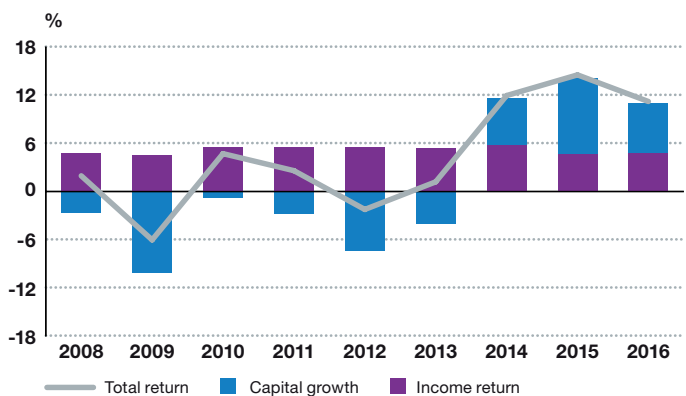
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

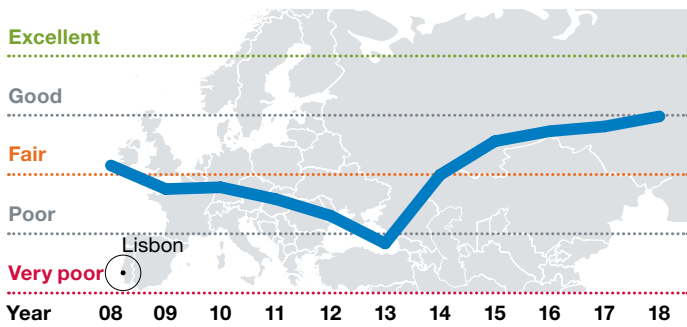
All-property return, 2008–2016



Source: MSCI

Lisbon (=11)

Investment prospects, 2008–2018



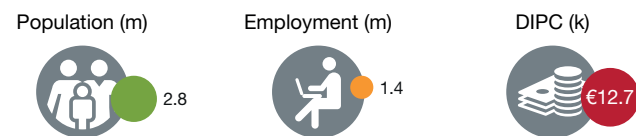
Source: Emerging Trends Europe survey 2018

Portugal's capital is a city to watch. For every pan-European respondent who says the market is too small and too illiquid, there is another who is either already investing or, more likely, sizing up the opportunities.

Some of this is about willingness to take a bit more risk to widen the playing field, and those deciding to go ahead include core/core-plus investors, not just private equity funds finding fewer deals in bigger cities as the real estate cycle matures.

“Portugal is a relatively small country with question marks about liquidity. However, we are looking at a few things because there is a lot more activity than there was, say two or three years ago. It is a market that we would consider,” says a large pan-European investment manager.

Population, employment and disposable income per capita, 2018

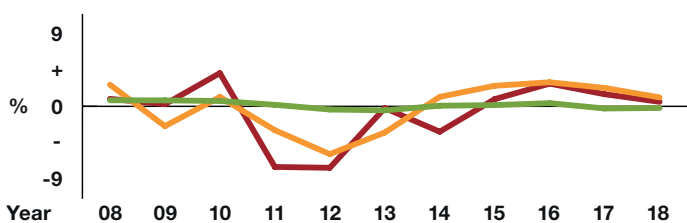


Source: Moody's Analytics

“We are expanding the number of cities we will consider to include Lisbon. This is to widen our opportunities as we expect to have a larger amount of equity to invest in our latest vehicle,” says the manager of a pan-European fund series.

In common with cities as different as Helsinki and Athens, Lisbon is one of the handful of office and retail markets offering the prospect of significant yield compression. Buyers can acquire fully-let, office buildings at 7 percent yields, and the EXPO Parque das Nações and waterside Santos Design districts are attracting investors.

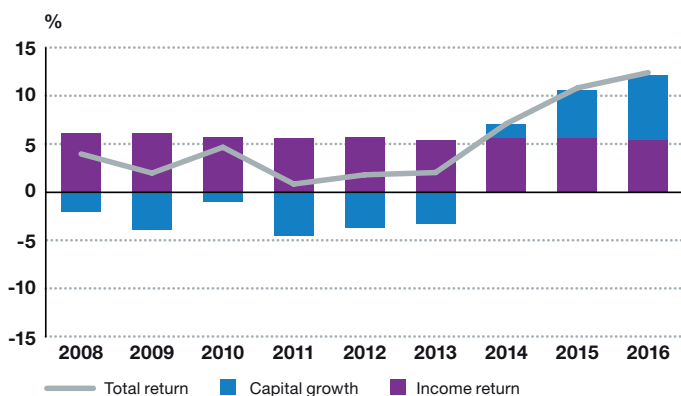
Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

The country's robust economic growth under a minority socialist government pursuing anti-austerity policies has been one of the positive surprises of the last two years. “Portugal's economic story is pretty good, maybe not as compelling as Spain but positive,” considers one opportunistic player. “Lisbon and Porto benefit from some of the same things as Barcelona, like good weather, cheaper labour and good English and language skills. This makes the capital attractive for back office functions, and the Lisbon office market is very dynamic.”

All-property return, 2008–2016



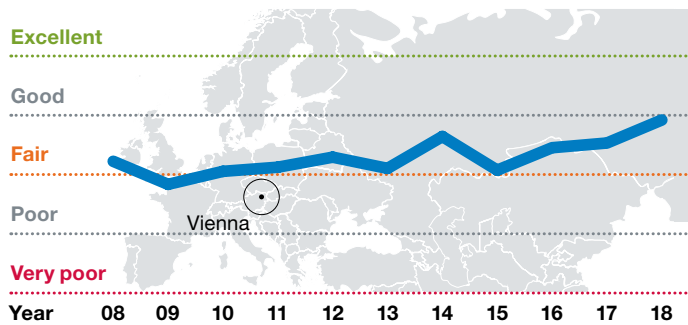
Source: MSCI

Nascent niche sectors like student accommodation are generating interest, and one German-based sector specialist has a 250-bed scheme in the works and a second on the way in the capital. Another fund manager says: “We're looking at retail in Portugal as well as Spain to see if we can find a well-located centre that needs some work. Investors are hunting value.”

There could, however, be an amber light flashing over Lisbon's downtown residential market which may be overheating, fueled by Chinese and French investors lured by generous tax incentives and “golden visas”. “The prices are way higher than most Portuguese can afford,” says an opportunistic investor. “So as people are pushed out of the centre and want to buy houses again, that could present an opportunity to develop in other areas of Lisbon.”

Vienna (13)

Investment prospects, 2008–2018



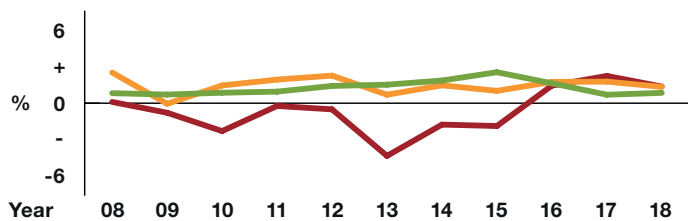
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



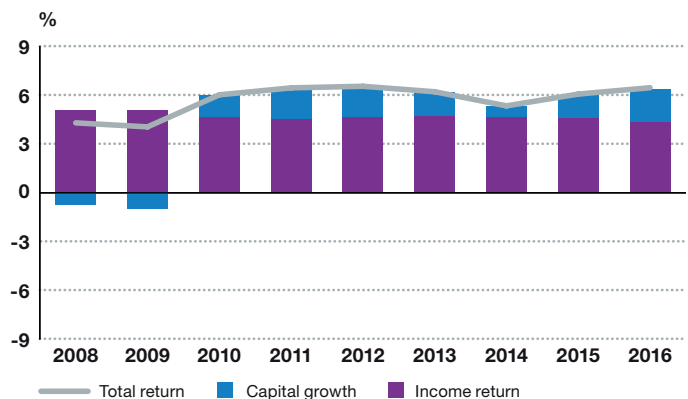
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

“Everyone wants to invest in Vienna,” says an Austrian interviewee. “More transactions were seen over the last year than in previous years. This trend will continue for the coming year.”

The evidence backs up that assertion. Total investment in the Austrian commercial real estate market reached €2.4 billion in the first half of 2017, up 80 percent on the last six months of 2016, and around three-quarters of that volume was transacted in Vienna.

German investors have led the charge, accounting for more than half of the capital entering the market over that period. German funds accounted for two of the biggest deals of the year: Allianz Real Estate purchased The Icon Vienna office development, while Deka snapped up Austria’s tallest office building, DC Tower.

“Yields have further decreased since last year, even though it was almost unimaginable,” remarks a local. Record low yields of less than 4 percent for prime offices and below 3.5 percent for the best retail investments are now established.

“We would buy more in Vienna, but it is not easy to find standing investments that make sense for us. There is a lot of competition, and I would say it is overpriced,” says an interviewee.

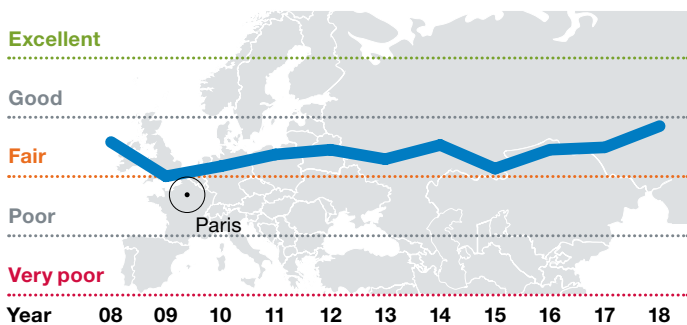
However, another argues that prices are sustainable given current market conditions: “At these yields it can only be viewed as “parking money” for times of crisis. Prime assets in Vienna are currently not overrated in perspective of the favourable lending terms available, and one would have to pay negative interest rates on cash deposits anyway.”

A high quality of living continues to draw people to Vienna; in 2017 Mercer ranked it the most liveable global city for the eighth year in a row. Consequently, several interviewees identify some residential subsectors as areas of opportunity. “Luxury residential will peak soon, but affordable housing will boom,” predicts a local.

Another investor adds: “Student housing still gives opportunity for constant and very good cash flows in Vienna, and while more projects will come through, the market is still not saturated.”

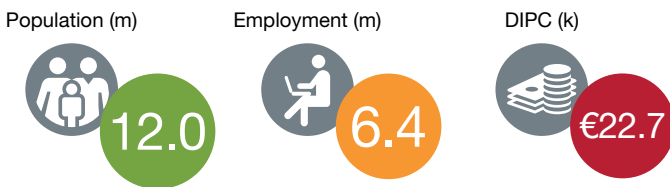
Paris (14)

Investment prospects, 2008–2018



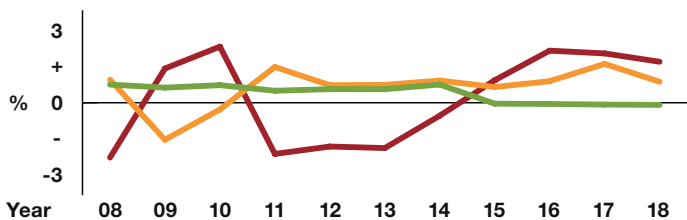
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



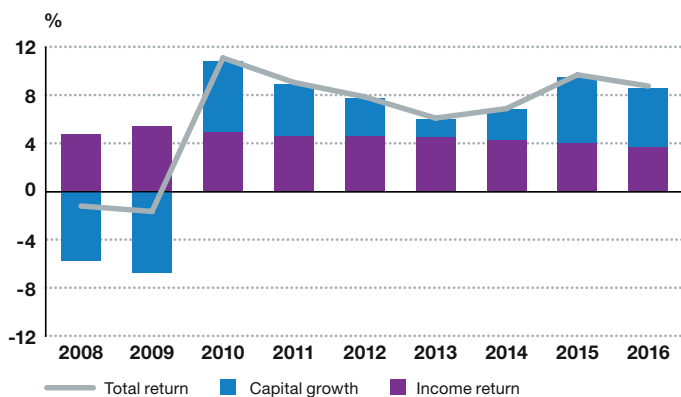
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

For international investors who focus on gateway cities, Paris remains one of the top three European cities to invest in, along with Berlin and London. Capital comes from all quarters of the globe, including increasingly from Asia.

But though Paris remains a deep and liquid market, it is clearly eye-wateringly pricey – in fact, it is the priciest capital in Europe, with yields for the most prime CBD buildings down to 3 percent and some even dipping below. What comes through in this year's *Emerging Trends Europe* is that investors need to be careful or mistakes will be made.

“Central Paris core has extraordinary yields and extraordinarily high prices per square metre,” says a private equity fund manager. “It has only got one place to go – although that doesn’t mean it happens quickly. Paris comes to mind as the first candidate that looks like it is in nose bleed territory.”

With fewer of what one institutional fund manager calls “accessible, straightforward office deals” available, competition is stiffer for refurbishments or buildings with vacancy. “There is a fair amount of capital, specifically with French strategies, starting to look at the Paris office market, some prepared to take on more risk with refurbishments,” says a placement agent. “Even insurance groups are now purchasing properties not yet rented out,” agrees a French developer.

Others suggest this is leading to overpaying: “I am more concerned by the buying of assets with complexities around building permits or huge refurbishment programmes at prices that are crazy than very low yields on properties with good fundamentals,” one says.

What underpins these prices is the prospect of rental growth, with rents on a positive trend. “Yield compression remains possible in the outskirts of Paris. Rents have been steady for many years, and there is potential for a rise as we are far from historic highs,” says a developer. This potential accounts for the city’s rise three places to sit in the upper half of the rankings.

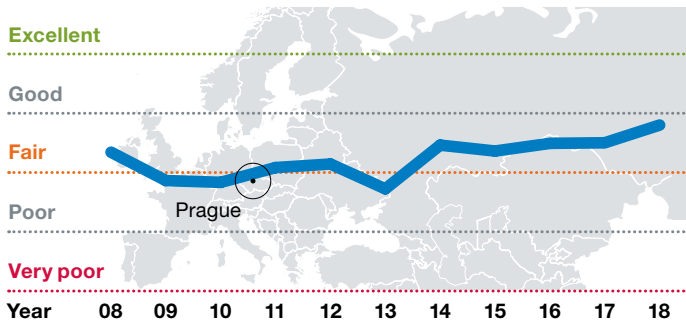
The investment going into the Grand Paris rail/metro expansion project and the 2024 Olympics will support development and rental growth in micro-locations, respondents believe. Paris is also one of those most strongly tipped to benefit from Brexit.

And then there is the “Macron effect”. The election of the new president and government has improved confidence in France and its capital city and also introduced an expectation of a further boost from reforms to tax and the labour markets.

“I am more confident about Macron’s ability to change France than about the UK with Brexit,” confesses the head of one large North American investor. “France isn’t leaving Europe, and he’s got a realistic chance of achieving his aims notwithstanding internal challenges. We are still buyers in Paris, and we are ready to develop there.”

Prague (15)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

A four-place rise in Prague’s ranking this year reflects how the city has entrenched its position as a mainstream destination for property investment in Europe.

The Czech Republic saw €2.1 billion of commercial real estate traded in the six months to June 2017, the highest first-half performance on record. “The market was very active in the last year and continues to follow that trend this year,” says a local.

“Investors generally find the Czech and Slovak markets stable and transparent. The market is prepared for a strong increase of investments coming from abroad, however there are only limited opportunities.”

Domestic buyers, including local retail funds and insurance companies, are also showing strong appetite for real estate. “The Czech market momentum is fuelled by local capital. There have been a couple of investments by Chinese investors, South Africans and Germans, but a lot of the money has been local,” remarks an interviewee.

Values have surged, and investors complain that acquiring property that will produce a strong return is increasingly difficult: “We have looked at some acquisitions there, but you’d have to find the right asset because it is pretty fully-priced right now.”

Population, employment and disposable income per capita, 2018

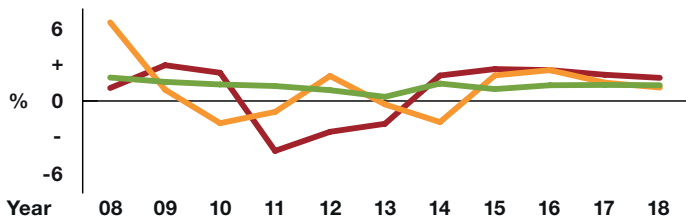


Source: Moody’s Analytics

Some are adapting their strategies to reflect the market’s higher status: “Prague continues to be robust so we are looking for things to do there which are outside our value-add box – more core product and build-to-core,” says one.

Low yields look justified, argues an industrial investor: “There are no external factors which might push pricing down in the Czech Republic. GDP is strong, and German industrial indices, which the Czech economy tends to track, are in good shape.”

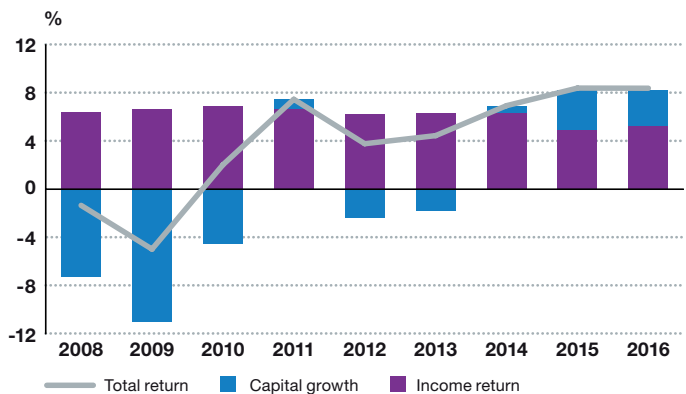
Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody’s Analytics

Another interviewee expects rental growth to drive returns: “Prague still has rents at historic lows. We just sold an office building at a record low 3.5 percent yield, but when I look at rents in that building they are 30 percent lower than in 2008. There is significant opportunity in Prague with the occupational market.”

All-property return, 2008–2016

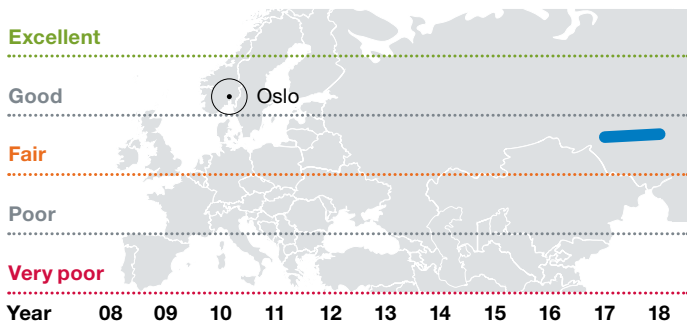


Source: MSCI

Prague’s historic centre is also a magnet for visitors, which helps to underpin the retail and hotel sectors. “Our city retail fund has been looking into Prague for quite a while, and we don’t see any problems there unless there is a terror attack. It is a very tourist-driven market so it’s pretty good if you have high street units,” tips a fund manager.

Oslo (16)

Investment prospects, 2008–2018



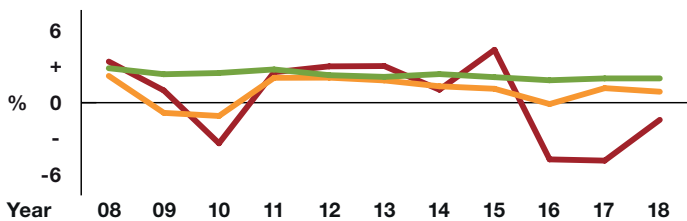
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



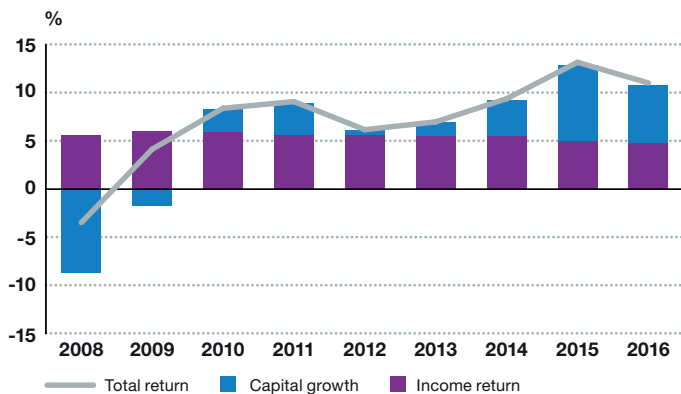
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Norway's capital is in many ways tracking Sweden's: in both, yields for prime assets have compressed rapidly in the last three years and residential markets are priced at historic highs.

At Number 16, respondents placed Oslo eight places lower than Stockholm, which may be a reflection of fewer opportunities available in its much smaller CBD.

The country is, however, enjoying a strong year, with investment volume up 58 percent to €4.2 billion in the first half of 2017 and one third of buyers being international investors. "Like Sweden, Norway has repriced very fast, leading to record transaction volumes, which we expect to see continuing," says the head of one Nordics advisory firm.

Investors like its super-strong demographics – of all the *Emerging Trend Europe* cities, Oslo has one of the wealthiest populations and lowest unemployment, so will likely only benefit from the predicted population growth of another 200,000 people by 2030.

Investor interest is across sectors and lot sizes. "The price movement has been so good that some investors are taking a profit earlier than expected," says the regional advisor, adding, "We know there are more things cooking in the kitchen, so there will probably be some large €200–€500 million transactions coming."

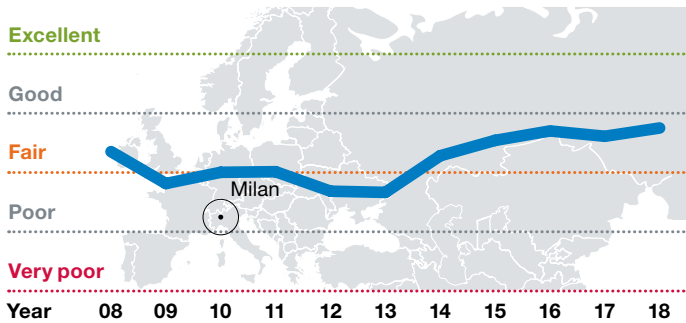
Sellers include regional private investors, municipalities and developers. A few international private equity firms who invested two to three years ago will earn juiced-up returns from the currency arbitrage available then: the krone fell after the oil price collapse in 2014 but has recovered as oil prices stabilised.

Places to tread carefully include prime Oslo residential, which some investors are avoiding for the time being because values are expected to fall. "But this is good, because you need corrections from time to time," says one interviewee. "It should just take prices down a little bit again, to the trend line, if you like."

Oslo is also a real estate market where occupiers place high priority on the green credentials of their buildings, while retail investors have an eye on the city's ambitious plans to reduce cars in the centre, initially via a controversial removal of on-street parking within the innermost ring road.

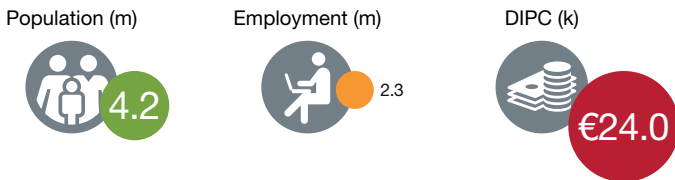
Milan (17)

Investment prospects, 2008–2018



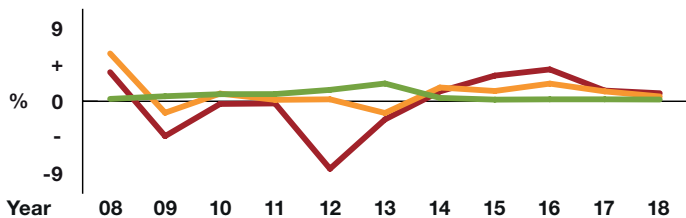
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



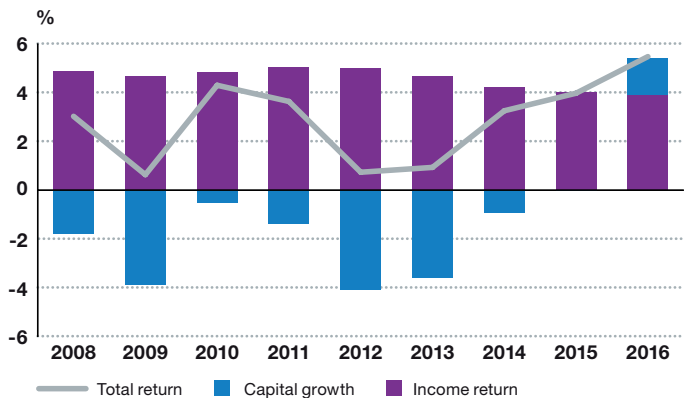
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Italy's top investment market slid two rungs, into the bottom half of the rankings this time, which is a surprise given the large number of interviewees who include the city in their target locations.

"Milan is on the map of major locations for capital worldwide. Real estate decisions now are based much more on cities than on countries, which is why there is alignment of cap rates here, comparable to other European cities," says a veteran local investor/developer.

Those low yields are not discouraging investors looking for core office, retail and logistics assets, with pan-European fund managers and French and German pension funds active buyers; Italian pension funds are also enthusiastic again after several years when they had reduced their investing.

Those brave enough to buy three or four years ago have been reaping impressive returns, helping a pick-up in investment activity that saw volumes in Italy roughly double in the first half of 2017 to around €5 billion.

With more demand than supply and strong rental growth, experienced players are more interested in taking some vacancy risk than they were last year, when the market was sharply polarised between core and opportunistic investors – but only in the best locations. "The opportunity is to buy core-plus to reposition with active management. There is strong potential in the coming years in Italy to upgrade or transform existing stock for other uses," says one.

The best office locations now include Porta Nuova as well as Milan's original CBD and districts like Milanofiori. Porta Nuova is finding its own momentum with more office, residential and retail planned there. Several interviewees are considering developing residential in the city, now that sales prices have been growing.

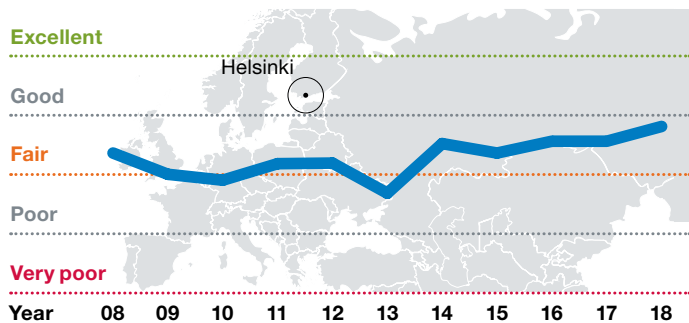
The well-connected Lombardy region also handles the largest share of Italy's distribution traffic, and cross-border investors are keen because the Italian logistics market has not repriced as fast as Spain's. Prime Milan yields were 6.2 percent at mid-year, says JLL.

Other things have moved in Milan's favour this year: concern about the populist Five-Star movement has lessened as political risk has subsided across Europe; more favourable personal tax incentives and a recent change to taxing carried interest as corporate dividends may attract more business talent to live in the country. And while Italy's bad loan problem has by no means gone away, some domestic banks are lending more and some German banks are back.

As one investor puts it: "Debt availability is better than 12 months ago and if we look at three years ago, it's another world."

Helsinki (18)

Investment prospects, 2008–2018



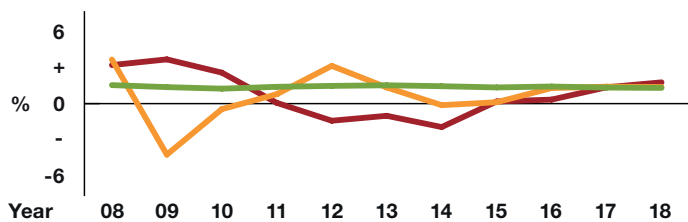
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016

MSCI does not produce an index for Helsinki.

“Helsinki had economic challenges, but is a city to watch,” says a pan-European fund manager.

Finland's GDP growth is weak, and though positive - the Bank of Finland is forecasting 1.7% for 2018 - it remains volatile. Another interviewee sums up the country's historical woes more colourfully: “It started with the Nokia crisis, then the financial crisis, then neighbour Russia's problems, and everything hit the country hard. But finally, Finland is coming up from the deep, dark valley.”

Because it is further behind its Nordic neighbours in the cycle, Helsinki's office market is seen by some as a place with opportunity. Average office vacancy across the Helsinki Metropolitan Area is the highest in the Scandinavian region at around 13 percent, but there is a shortage of high-quality buildings in the city centre. “We need to see the office market more balanced, then probably we are going to see rents coming up. So, there is interesting potential in Helsinki, both on the rental side and on the yield side as well,” believes an adviser working in the Nordics.

This backdrop explains why one of the largest-ever property deals in the Nordics happened here in 2017: Blackstone's €3.8 billion agreed takeover of Sponda. The Finnish company has a portfolio concentrated in Greater Helsinki, 60 percent of its offices.

Locals expect Blackstone to spend the next 12-24 months talking to tenants and lifting rents and values in line with the market's continuing recovery.

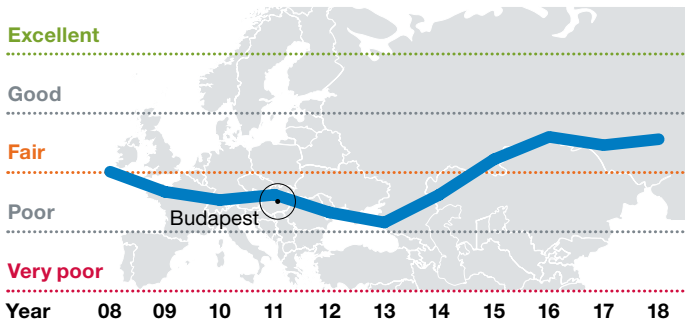
There is still a 50-100 basis points premium in Helsinki yields over Stockholm and Oslo, in sectors across the board, including the industrial and warehouse market, which particularly suffered from the sanctions imposed on Russia. But logistics investors are starting to view Finland more favourably. “Helsinki is better than Stockholm. Stockholm is also a good market, but the competition now is too hard,” one says. Interest from international investors is up across the board, with an increase in residential and hotel transactions.

As its recovery takes hold, another of Finland's differences from its Nordic neighbours is coming into play: its euro currency. This means euro-denominated pan-European funds can invest here, and a number are adding Helsinki to their list of target cities.

One challenge is that assets can be harder to finance, especially smaller non-core properties, or buildings with vacancy.

Budapest (19)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

Political risk remains the dominant consideration for many in weighing up investment in Budapest. However, the city's slightly improved ranking this year – up two places – suggests that some investors are becoming inured to the idiosyncrasies of the current Hungarian regime, particularly when considered in the wider context.

“The political cloud which hung over Hungary is still there, but now similar issues are increasing in Poland. However, they don't seem to have had a long-lasting effect on the property market, and in any case, are all overshadowed by bigger geopolitical issues such as Trump and Brexit,” comments a pan-European investor.

Population, employment and disposable income per capita, 2018

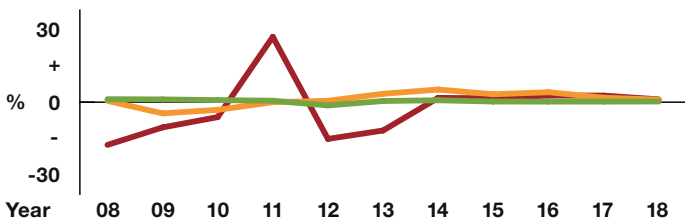


Source: Moody's Analytics

A CEE specialist adds: “The markets of central Europe have always had issues in terms of politics, and the market has always progressed in spite of them. Orban in Hungary is probably similar to the Polish regime at the moment, but he has become more reasonable now he has been there longer.”

Some low-risk investors are less sanguine, however: “We will not go there at the moment because we are cautious regarding the political developments. As core and core-plus investors, we rely heavily on stable and sustainable circumstances, and a political environment that respects internationally-agreed common rules. We don't see that in Turkey, Hungary and Poland,” says an international institutional investor.

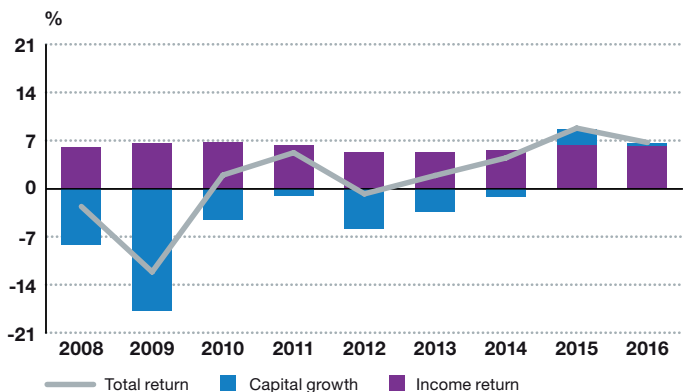
Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

A substantial volume of capital has nonetheless been drawn to Budapest because it offers comparatively low real estate prices. “In Hungary, the whole market last year was €1.1 billion, and it has seen €684 million in the first half of 2017,” says an interviewee. “In Budapest, there is still a yield differential. Prime office yields in Budapest are 6.2 percent. In Prague and Warsaw they are sub-5 percent. That is the opportunity there. And the occupational market has been very strong as well.”

All-property return, 2008–2016

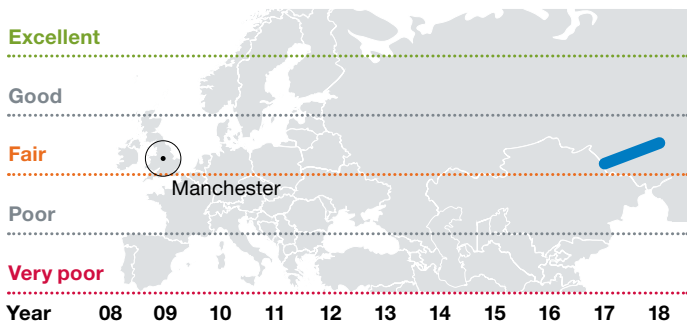


Source: MSCI

Prices are rising: “The Budapest market was stagnant for longer than other European capitals. It has now found its legs, but there's been rapid yield compression. It's less easy to buy there now than it was a year ago. However, it still looks good value on pricing,” says a pan-European investor.

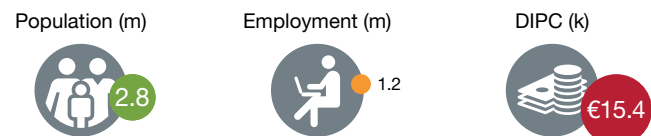
Manchester (20)

Investment prospects, 2008–2018



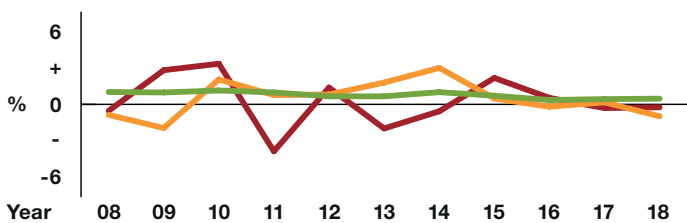
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



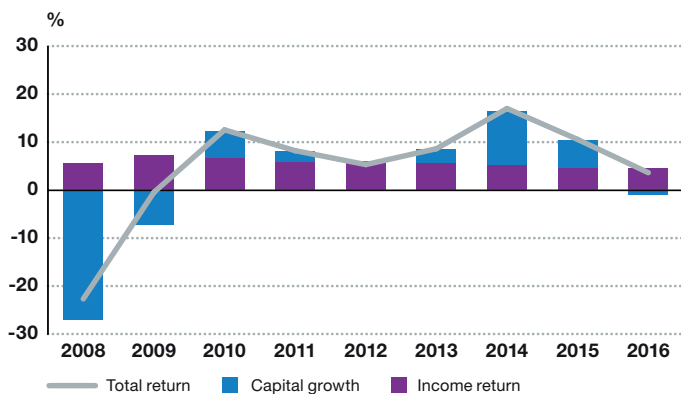
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Manchester's burgeoning confidence and status as the UK's "capital of the north" is reflected in the enthusiasm that sees it move up to Number 20 this year, notwithstanding the Brexit-shaped cloud looming over the British economy.

"There has been a shift in attitudes towards the regional cities, in particular favouring Manchester. Corporate occupiers are increasingly looking to Manchester as a viable place to occupy premises and pay increasingly high rents," says one global fund manager.

"UK regional markets are no longer just back-office destinations," adds another international investor. "You don't go to Manchester just because the people are cheaper. It is a consideration, but it is well connected, a nice place to live and bring up your family with cheaper occupational costs. A lot of big consultancies and banks have continued to go to those locations."

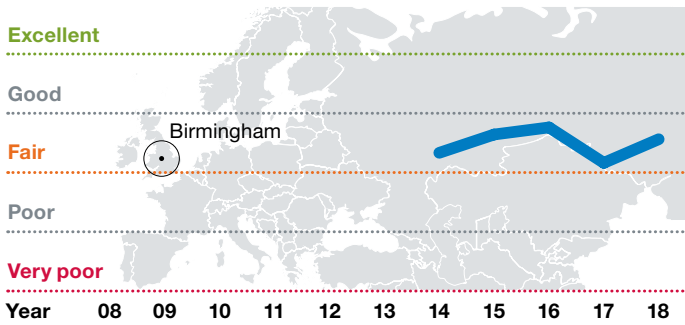
Office take-up kept up with the long-term average in the first half of 2017, and with no new building completions expected between the end of 2017 and the beginning of 2019, expectations for rental growth are high. Meanwhile, prices remain comparatively modest, with prime office yields standing at around 5 percent. "We see potential in so-called second tier cities like Manchester or Leeds, which are cheaper from a valuation point of view than the London real estate market," says a global fund manager.

Housing in Manchester and other regional UK cities is also attracting increased interest. "The numbers stack up better in regions, and there is less competition from housebuilders in particular. Too much competition in London makes numbers much more challenging," argues a residential investor. "The regions are potentially a little riskier but we understand that."

The caveat for many buyers remains the limited scope to invest large sums. "The problem for me as a financier is that in Manchester £50 million is a big deal, so that makes it challenging for big funds. It's easier if you're a property company working around the edges," comments an opportunity fund manager.

Birmingham (=21)

Investment prospects, 2008–2018



Source: Emerging Trends Europe survey 2018

Brexit looms large on the UK economic horizon, and evaluations of Birmingham’s prospects are coloured by whether the EU divorce process is viewed as an opportunity or a threat for the country’s regional real estate markets.

In the more optimistic view, capital scared away from a London market that is overpriced and over-reliant on the financial sector will find a home in Britain’s other large cities: “We expect London offices to face a challenging time. By contrast we expect the big six UK cities outside London to hold up quite well,” says a pan-European investor. A fund manager adds: “The fact that we have no London offices in our UK fund means our portfolio is doing well – because regional UK assets are doing well – and we’ve had client inflows as a result.”

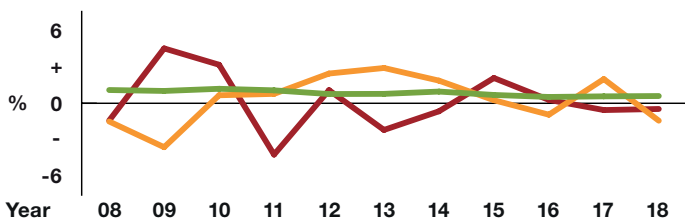
Population, employment and disposable income per capita, 2018



Source: Moody’s Analytics

Another global investor is “still positive” on Manchester and Birmingham, drawing a distinction between these “key regional cities” and smaller secondary cities where Brexit will have “a negative impact ... for years to come”.

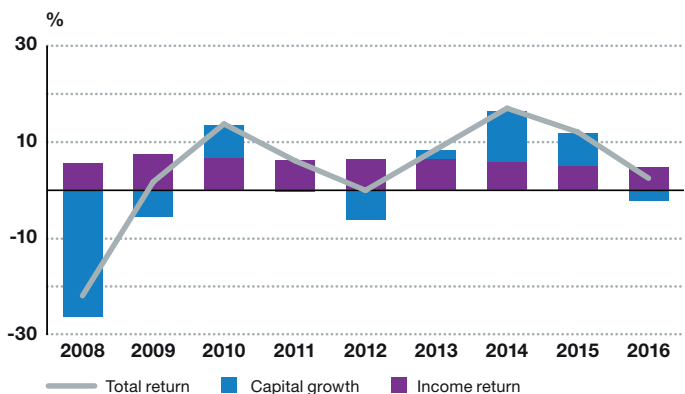
Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody’s Analytics

The opposing camp suggests that all regional economies, including Birmingham, may be less able to ride out a potential downturn than the capital: “Since Brexit, the UK is a bifurcated market. Trophy-hunters have bought some of the large City of London buildings at pretty astounding pricing; whereas for the bulk of the market, the assets that are either a little bit off-pitch or in a more regional location, there’s uncertainty about what the economic climate’s going to be like going forward,” says a pan-European adviser.

All-property return, 2008–2016



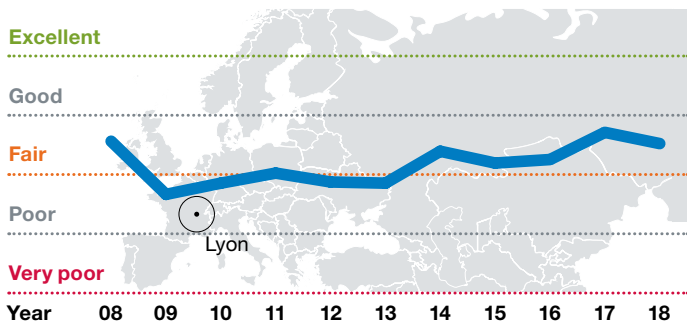
Source: MSCI

The first elected Mayor of Birmingham took office in 2017, and the city is attempting to negotiate an improved devolved funding package from central government. Meanwhile, investor sentiment has received a boost from the ongoing HS2 rail project: “We have bought assets in Manchester and Birmingham over the last couple of years, and we are still looking. The infrastructure investments in high speed rail will be a fantastic way to connect those cities to London,” says a long-term German investor.

Birmingham sits at the heart of the UK’s distribution network, and logistics remains highly sought-after for buyers that can afford it: “We have been buying up regional UK offices where we can still find value, but if you’re buying a shed in the UK it’s unbelievable pricing – some of them going for sub-4 percent yields.”

Lyon (=21)

Investment prospects, 2008–2018



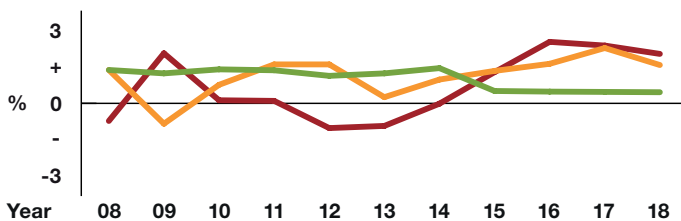
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



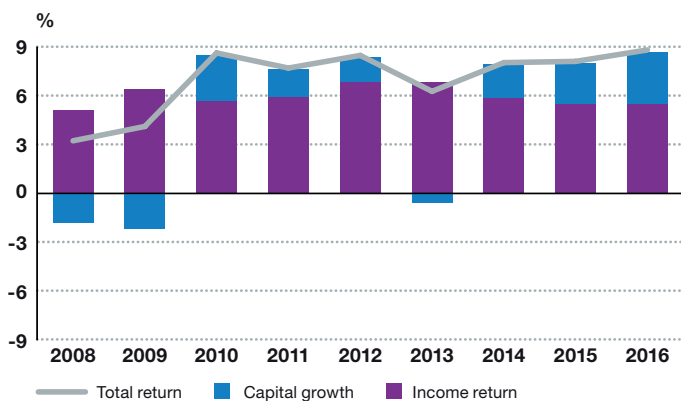
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Lyon's defining feature this year is that it is the biggest faller, plunging 11 places out of the top 10. Which begs the question, why?

The answer could be that it has simply become relatively expensive instead of relatively good value against the other cities with which it is usually compared: Paris at one extreme and second-tier markets in France and around Europe at the other.

None of the fundamentals about Lyon's strong and well-diversified local economy has changed, but office yields tightened rapidly through 2016, to 4 percent. This has narrowed what had been a more than 100 basis point premium over Paris yields and makes the city much pricier than Marseille, Toulouse or Bordeaux, leaving no room for further yield shift.

As one senior fund manager puts it: "Lyon is an interesting city with plans for economic growth in various areas, and if you had been looking two to three years ago there was quite a yield difference. At the present time, that might be a bit tricky because the pricing is not reflecting the difference with larger markets."

It may also be facing a little more competition from other French locations, such as Bordeaux, now 75 minutes closer to Paris via its new TGV. "Lyon remains a good destination. Bordeaux has a lot of potential – it's an attractive city, with improved connections," says an experienced French developer.

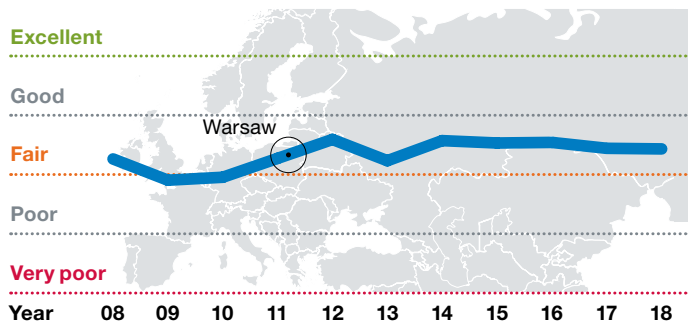
For those comfortable with Lyon's yields, investments can be hard to find. The market is dominated by French investors, who have accounted for three-quarters of all trading in the last couple of years. Examples are Amundi and Caisse des Dépôts, which in joint venture made the biggest splash this year buying the 66,000 square-metre "To-Lyon" development near La Part-Dieu, scheduled for delivery in 2022. German institutions, particularly the open-ended funds, are domestic investors' principal competition.

"Lyon is one of the bigger cities in France, the economy is well-diversified, there are a lot of universities and unemployment is low. It's a real second market for France after Paris," says a French fund manager of one pan-European fund looking to buy here. "You see some leading companies based in Lyon, like Sanofi, but you also see IT companies based there. We like it."

Greater Lyon is one of the top three markets in France for logistics, due to the city's location in the prime north-south corridor, connecting Lille in the north, via Paris then Lyon, and then on to Marseille in the south. Logistics is also the property sector in France with most international investor penetration – 60 percent of acquisitions are made by overseas firms – and L'Isle d'Abeau on the city's outskirts is the largest distribution park in France.

Warsaw (23)

Investment prospects, 2008–2018



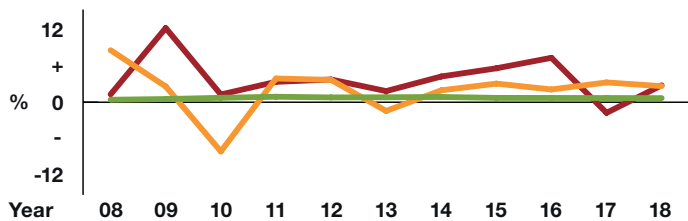
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



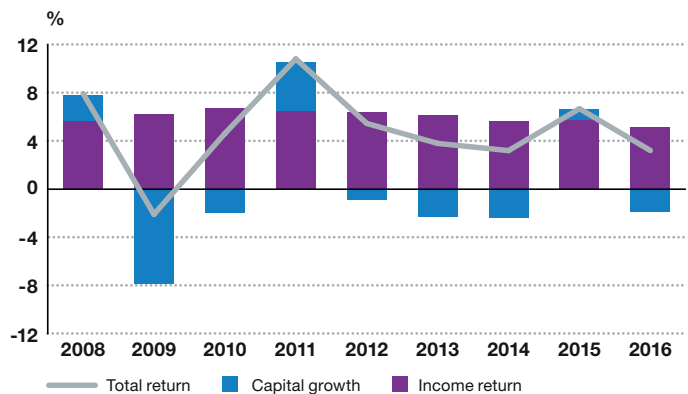
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

The perception of increased risk has contributed to Warsaw slipping three places down the ranking to Number 23. The political turmoil and mass protests that followed the ruling Law and Justice party's controversial proposals to reform the country's judiciary have disturbed some foreign investors.

"Investors are holding daily conversations about the situation in the country. The message sent to foreign investors is rather discouraging," adds another.

Last year, the government closed loopholes that allowed some businesses to avoid paying VAT, and it may need to raise more revenue to meet domestic spending commitments. "There is nervousness in Warsaw over the tax situation," admits a local.

The dynamics of the city's property market is also a worry for some, particularly within the office sector. "I am deeply concerned by the development pipeline in Warsaw. Too much stock is being built and there are not enough tenants, so it is not a good idea to buy there," says an investor.

Supply is not the only factor contributing to the sense of unease: "There is uncertainty around office investment due to the gap between headline and effective rents due to large incentives. Some people think that the real estate market will be in trouble soon because the prices are unjustified."

However, Poland's vigorous economic growth, forecast at 3.2 percent in 2018 by the European Commission, means that Warsaw still has plenty of fans. "Take-up has been more significant than the market expected. That nervousness will start to disappear as the take-up shows that oversupply is nowhere near as bad as people thought it would be. There is an incredibly strong occupational market in Poland."

A CEE investor adds: "An opportunity for the office market stems from continuous positive arbitrage in wages between Poland and western Europe. Business process outsourcing and shared service centres will continue to have an impact on this market."

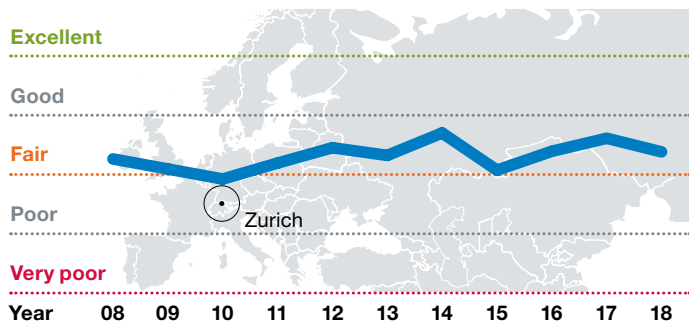
In addition, Warsaw has established a position as a financial hub for the CEE region, attracting occupiers including Credit Suisse, Goldman Sachs and JP Morgan. "Those companies are representatives of global business, and their arrival is not just attributable to the UK leaving the EU. Poland is a great venue for mid-office functions and also for residential."

Some interviewees believe that any decline in interest from western European capital due to the political situation will be made up elsewhere: "Poland may become targeted by investors who are accustomed to operating in countries with uncertain political and legal environments," says a local.

Meanwhile, investors will be monitoring the Polish government's pledge to introduce REITs, with the legislation expected to come into force in early 2018.

Zurich (24)

Investment prospects, 2008–2018



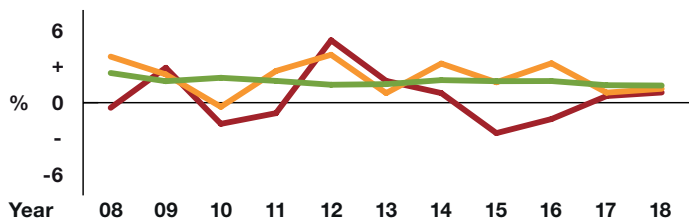
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



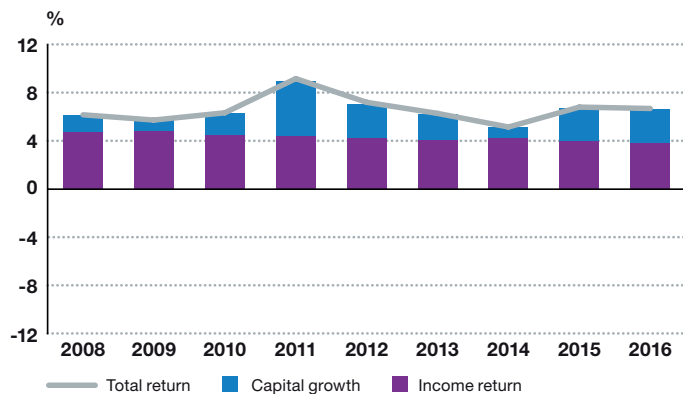
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Zurich is universally regarded as a stable market, Mercer's quality of living ranking rates it as the second most liveable city on the planet, and no-one is overly concerned about the resilience of the Swiss economy. When those factors are taken into consideration the city's abrupt 11-place plunge to Number 24 in this year's ranking represents something of a conundrum.

The answer may lie in a symptom of Zurich's success. Competition for prime assets is high across most European markets, but in Zurich it has reached levels that are making even the most cash-rich buyers hesitate; yields have been reported as low as 2 percent for the best offices. "Prime yields have reached their long-term low," says an interviewee.

With Swiss government bonds still offering negative yields, demand from domestic investors for core real estate, which has offered comparatively attractive risk-adjusted returns, has been extremely strong. "It is hard to find the right assets. The prices are high, and a lot of Investors want the same product," comments a local institutional investor. It is even tougher for foreign buyers to access the market: "Switzerland is too local and very expensive," says one.

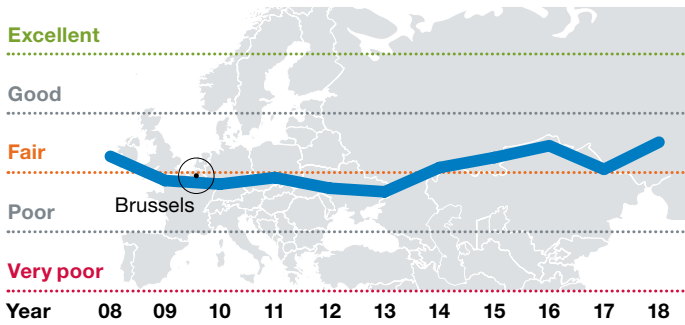
Those willing to pay such high prices may have other reasons for doing so beyond seeking returns. One investor who recently bought a prime office in Zurich at a very low yield, says: "That did not meet our return expectations, but through diversification lowered the risk level of the portfolio so substantially that the overall figures improved."

With property changing hands at such low yields, the risks contingent on a rise in interest rates are amplified. "Interest rate changes are perceived as a low-frequency but high-severity event. If there is a sudden increase of a couple of percent there will be a significant market reaction," warns a Swiss investor.

"It would not be so bad if rates were to increase in the short term. That would cool down the market and make competition a bit more reasonable. In the environment we have now, there is an ongoing downward pressure on yields in real estate, and if that continues we could end up in a bubble."

Brussels (25)

Investment prospects, 2008–2018



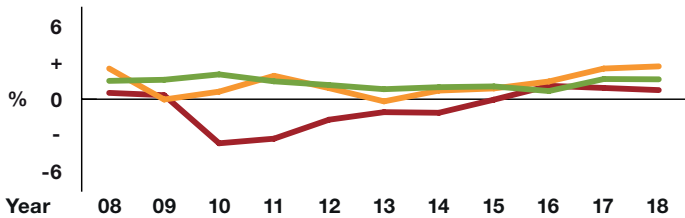
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



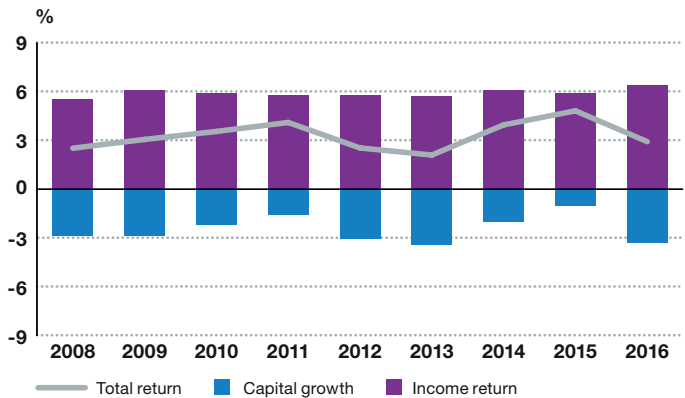
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Brussels remains a city that fails to inspire fervent enthusiasm among *Emerging Trends Europe's* interviewees, which perhaps explains the Belgian capital's lowly ranking, despite the apparent health of its real estate market. "Investors like to buy in more sexy cities. Brussels is not a sexy city. The risk is higher and taxes are high," says one.

Another describes the Belgian capital as a "steady Eddie" market. "With 1.7 percent GDP growth, you can only create so many new offices, plus the British will be going and leaving offices behind. If you are in the right spot in the CBD or have the right size of building it's OK. You will never become a billionaire here, but you won't go bankrupt."

Nonetheless, such is the weight of capital seeking European real estate that yields have continued to compress. Long-leased office properties are trading at 3.75 percent and prime high street retail at 3.5 percent. "Prices are getting irrationally high. New investors are investing in Brussels. It is very hard to buy, and sometimes it is actually better to sell. It is however expected that this will be one of the last years where the market is so hot," says a German investor.

Despite an improving outlook for economic growth, some international investors are concerned that the country's high sovereign debt could leave it exposed in the event of a global shock. "There is no sign of a clear fiscal policy," complains a pan-European fund manager. "Infrastructure and environmental legislation are cumbersome. Parking taxes and registration duties are too high."

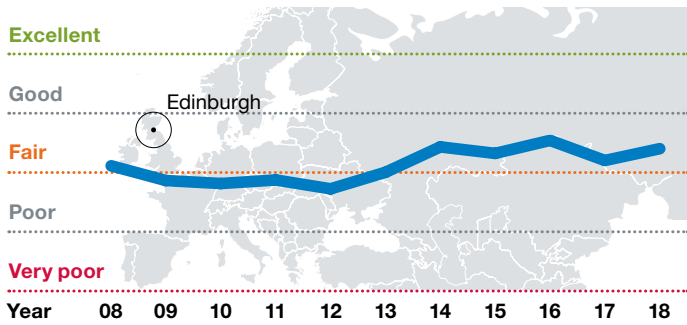
Those underlying concerns may impair the market in the long term, but they have so far failed to deter investors: "Brussels will always be on our list because of the good sales we manage to make despite the downsides."

Pockets of opportunity include the housing market: "In terms of demographic developments, the projections in Brussels are high. Therefore, the building of apartment buildings is on the rise. We can also find many empty office buildings in Brussels, which leads to some transformations of office buildings into apartments," says an institutional investor.

Some interviewees speculate that Brexit might have a positive impact. "It has opened a few opportunities for Brussels, as the capital of Europe, to attract large corporates," says a local investor. Others are more sceptical: "Belgium cannot be seen as a traditional country for corporate European headquarters," is one dissenting opinion.

Edinburgh (26)

Investment prospects, 2008–2018



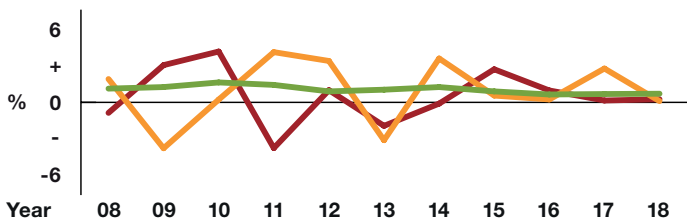
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



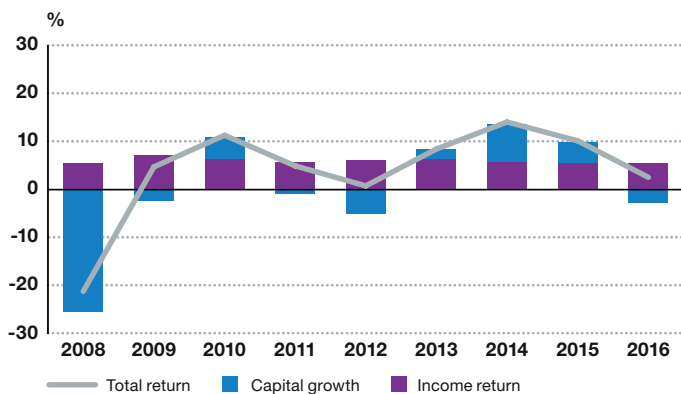
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

The UK general election in May 2017 represented a setback for the Scottish National Party, as its unionist opponents made gains. Consequently, plans for a second independence referendum have been put on hold, raising hopes in Edinburgh's property market that investors who have shied away from the Scottish capital because of the country's hazy political outlook will now return.

"We have not seen much interest from UK institutions in prime Edinburgh CBD property until recently because of the political uncertainty and risk," says a local. "Buyers of bigger assets tend to be overseas funds that are less concerned about domestic constitutional matters. After the general election we saw a change in the mood of voters towards the SNP, and that has been reflected in a little more interest from the UK institutional market in Edinburgh."

Some investors are still deterred by a perceived unsupportive tone among authorities north of the border, however. "We don't favour Scotland due to the Scottish government's anti-landlord, anti-business posturing," says a London-based investor.

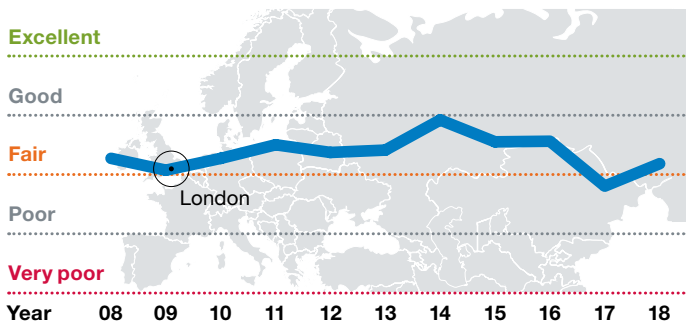
Nonetheless take-up in Edinburgh's office sector has been strong in 2017, led by the Government Property Unit, which has signed up for more than 16,700 square metres of space. "We have seen some "north-shoring" with legal firms, for example, moving out of London to other parts of the UK to take advantage of cheaper rents, but also highly-skilled talent pools around the big regional cities like Manchester and Edinburgh," comments an interviewee.

Meanwhile the mixed-use Edinburgh St James scheme under construction could boost retail and leisure in the surrounding district. "There are a lot of hotel and restaurant investments going into the East End of the city off the back of that. It is only a matter of time before investors will pay a slight premium for that area," comments a local.

The principal challenge facing potential investors is that there is very little to buy. Only £91 million was transacted in the first half of 2017. "The market is small, so if you are risk-averse the number of prime locations is very few, and we have an exceptionally risk-averse property market that steers clear of new development unless it is pre-let or pre-committed in some way."

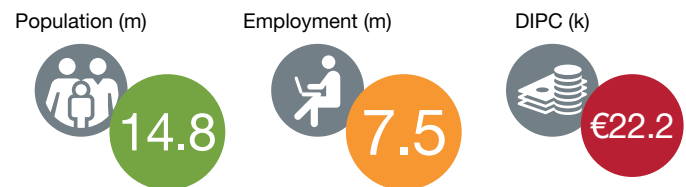
London (27)

Investment prospects, 2008–2018



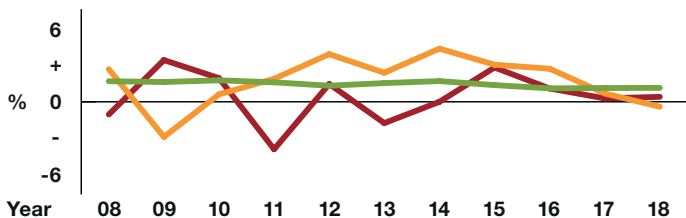
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



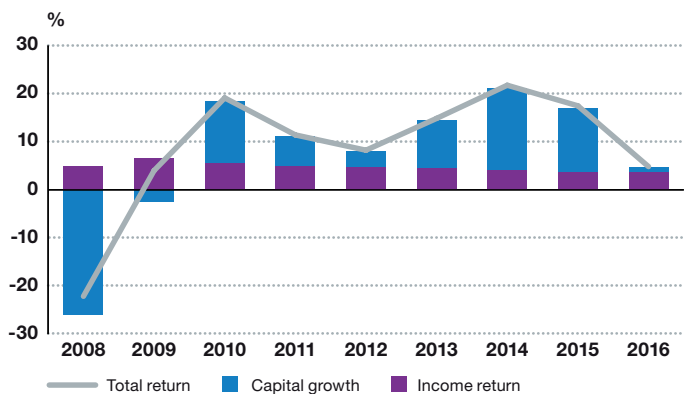
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

London continues to languish near the foot of the rankings again this year. Brexit still subdues interviewees' expectations of a market that was already considered by many to have peaked.

"London is not going to offer investors very much in the next couple of years," cautions a leading UK-based property investor. "We believe that we have reached the peak of asset pricing and rental values are under pressure, so returns will be low."

Domestic investors are selling: "Prime assets are at the top now, which is why we are seeing a lot of CBD office buildings going up for sale", yet properties continue to find buyers despite low cap rates. Investment volumes remained robust in 2017, buoyed by the sale of two of the City of London's landmark skyscrapers.

"Uncertainty has certainly not dampened down liquidity and pricing for grade A stock in London. Since Brexit, you've seen the sales of the Walkie Talkie, Cheesegrater and other good buildings let to good tenants on long leases going out at record yield levels," remarks a fund manager.

London remains a safe harbour for Asian capital in particular, and its appeal has only been enhanced by the decline in the value of sterling following the EU referendum: "What Brexit did was devalue the pound, and so instead of buildings being devalued, pricing has remained the same because of the currency," comments a financier.

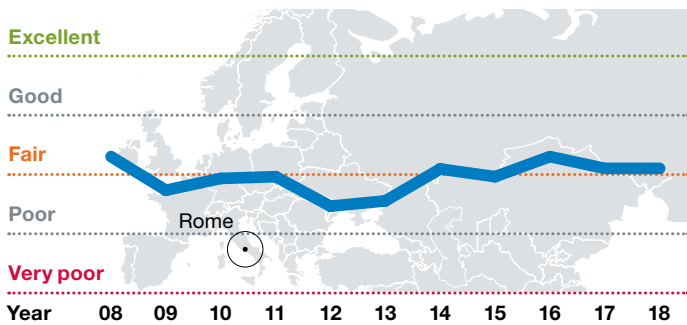
Some observers believe a correction is inevitable: "Prices are not really factoring in what is likely to be coming. There are plenty of cranes in London, so there is supply coming through. If we get a significant slowdown in demand there will be an imbalance, and that will begin to impact next year. We have scenarios on London rent correction ranging from 10 to 20 percent."

However, investors seeking bargains have been disappointed so far: "There are a lot of people with a war chest ready and waiting in London, as we have been, for distress, which just hasn't come."

Moreover, some interviewees are certain that the current climate of political and economic uncertainty will have limited long-term impact on a market of London's size and diversity: "We have seen fluctuations in the London and British markets for decades, and we think this is just another fluctuation."

Rome (28)

Investment prospects, 2008–2018



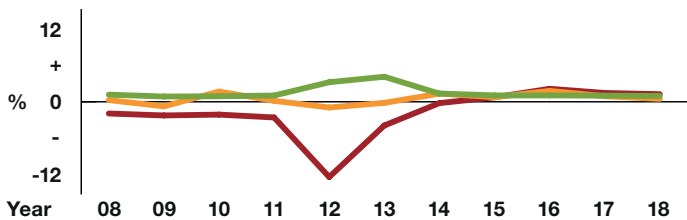
Source: Emerging Trends Europe survey 2018

Population, employment and disposable income per capita, 2018



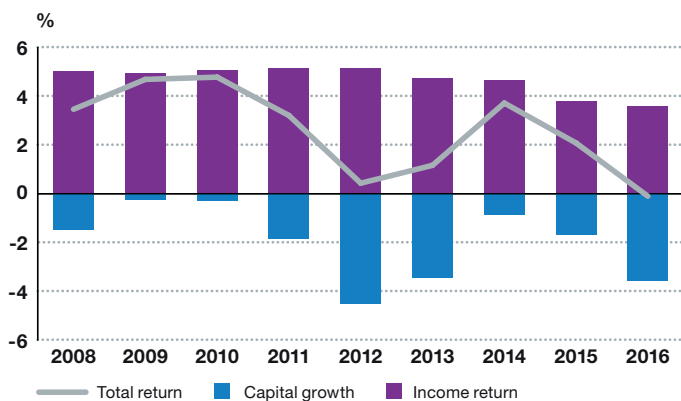
Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016



Source: MSCI

Rome is enjoying a sustained surge in Italian tourism, which is underpinning its thriving hospitality business and benefits the retail sector. The Lazio region estimates tourist numbers in the capital are up 3 percent this year.

“Rome is of great interest for hotels,” says one international investor. However, although a lot of investors also scour the city for office opportunities, they are not all prepared to pay the keen yields they might in Milan with its more diverse occupier base and more business-friendly mayor.

This has kept Italy’s capital city towards the bottom of the rankings, this year at Number 28. One recurring comment is that the office market remains too dominated by government and public sector occupiers. “We are reviewing some office assets in Rome,” says one Paris-based fund manager. “But yields have been going down sharply in the last few months in Rome as well as Milan, and we are reluctant to consider a property let to a public administration. So, it is a difficult market for investments.”

“Rome is not yet ready for value-add office investing; for us it is a much more difficult market,” says another. “Take-up is slower, and it is risky to do large, value-added development.”

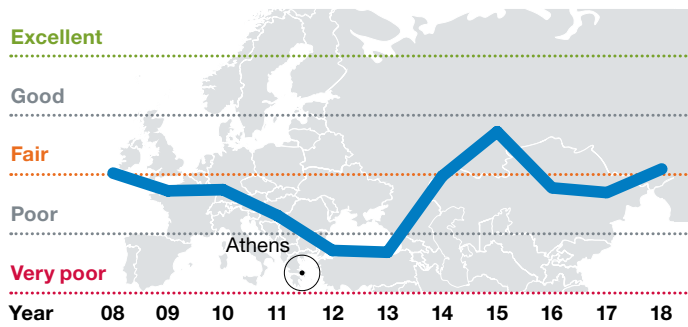
Another perceived negative is Rome’s anti-establishment, Five-Star mayor who was elected last year, with Italian interviewees the most openly critical. “It is a completely different political situation to Milan,” one says. “Milan is changing for the better; the same cannot be said of Rome,” says a second. “Many operators are changing the focus of their business from the second city to the first.”

Italy’s large stock of non-performing loans also deters some investors; the country accounts for 30 percent of the euro area’s total NPLs. Italian banks still had €210 billion of bad property loans on their books in June 2017, which has limited new lending. However, “financial institutions have begun to give credit again, even if they are more prudent and selective”, says an Italian investor.

One banker sums it up this way: “The banking system is just now starting to be dealt with, 10 years after, and as a consequence of that, Rome is not performing. Milan is where activity is picking up.”

Athens (29)

Investment prospects, 2008–2018



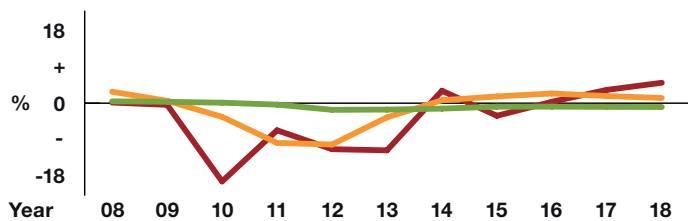
Source: *Emerging Trends Europe* survey 2018

Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

All-property return, 2008–2016

MSCI does not produce an index for Athens.

Interest in Athens is quietly picking up and perhaps belies its spot, just two places off the bottom of the overall rankings. It is true, it is not hard to find large, pan-European investors who buy in southern Europe but “just don’t go to Greece - we don’t have a local team there”, as one puts it. However, a number of international investors committed capital in 2017 and put boots on the ground.

The sector attracting most interest is hospitality, which is not so linked to the local economy. International arrivals have gone up in each of the last three years, and the country is viewed as a safe European holiday destination. “Everyone who comes to Greece is interested in hospitality, so you have to join the queue,” says a wry local adviser.

Prominent Athens hotels have traded at less than replacement cost this year, and the buyers can bring in management skills honed in other markets. In the vanguard are US investors and private equity firms, often operating with local partners.

Chinese capital is going into logistics at Piraeus Port, and shopping centres are beginning to attract opportunity funds. Like hotels, retail including food and beverage gets a boost from tourism which accounts for 18.6 percent of the country’s GDP.

Prime office yields have started to move in slowly off the bottom, and Athens is one of the few cities left in Europe where there are opportunities for yield compression. *Emerging Trends Europe’s* survey participants may have had this in mind when they scored its capital value prospects above 12 other cities.

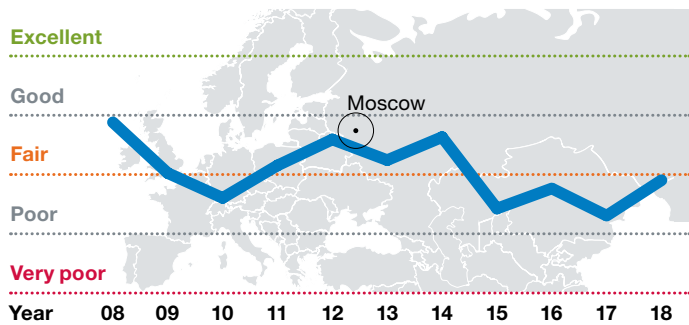
Yet although there is a lack of good stock of all asset types, locals say it is too early in the recovery to develop; recapitalisation is seen as the better bet for the brave.

Non-performing loans remain a huge headache for Greece with €101 billion clogging the books of its banks: an estimated 60-70 percent is either commercial real estate loans or collateralised by real estate. The Greek banking system has set an ambitious target of reducing it by €40 billion by the end of 2018, which will test investors’ appetite.

And the country is still under EU supervision. However, in a change from even one year ago, people think the possibility of a Grexit has passed, and sentiment has turned. As one experienced pan-European player now operating there says: “Investing in Greece doesn’t feel so crazy.”

Moscow (30)

Investment prospects, 2008–2018



Source: *Emerging Trends Europe* survey 2018

Population, employment and disposable income

Moody's Analytics does not currently provide these figures.

All-property return, 2008–2016

MSCI does not produce an index for Moscow.

Despite Moscow still languishing near the foot of the rankings, investors in the Russian capital are upbeat about the prospects for a market that appears to be emerging from recession.

“We are more risk-on now for Russia because values have been driven down so dramatically and the fundamentals of the economy are improving. We are structuring deals that are very robust with lots of downside protection though,” says an international investor.

A private equity manager echoes this positive tone: “The Russian market represents a unique opportunity at the moment where you can buy quality assets at prices which are very close to replacement costs. The market still is not very liquid, but we clearly observe recovery for good real estate.”

The face-off between Russia and the west brought economic sanctions that pushed the country's economy into recession in 2015 and 2016. It also resulted in an exodus of foreign investors. “We are not invested in Russia and China because they are big enough to ignore the market, and they have a political system that allows them to ignore the needs of their people,” says a German institutional investor.

Many US and western European investors share that view, and for institutional core investors Russia is still a no-go zone, but its economy is in recovery with the World Bank projecting GDP growth of 1.4 percent in 2018.

Some see indications that foreign capital is returning: “We believe that in mid-term more and more foreign investors will come. They are already here despite all sanctions and conflicts, and with further improvement of the geopolitical situation, western investors will be attracted by the highest returns in European market.”

Meanwhile domestic capital is playing an increasingly important role: “Russian pension funds and private groups are a big part of the market right now.”

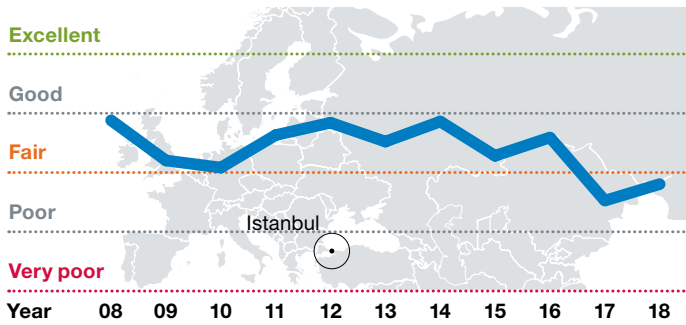
While still expensive by European standards, borrowing costs are falling: “Russian banks are flush with liquidity so the cost of debt financing is coming down rapidly, and that is happening at the same time as the inflation rate is falling dramatically. It is definitely feeling a lot better in Russia,” says an interviewee.

The residential sector offers burgeoning potential, argues an international investor: “Russia has a wealthy middle class in Moscow with ageing parents, and the quality of residential property needs to improve. In the future, there could be niche opportunities such as for-lease housing and senior living.”

The political outlook is still highly volatile, but: “The Russian market is known for being able to bounce back fast. When it does, the increase will be significant because investment volumes are so low at the moment.”

Istanbul (31)

Investment prospects, 2008–2018



Source: *Emerging Trends Europe* survey 2018

Istanbul has fallen from 14th place two years ago, to 28th last year, to being the bottom city in *Emerging Trends Europe's* rankings.

The city of 15 million people could offer many opportunities for real estate companies: it has a young population, a huge need for more and better housing and many existing buildings that would benefit from being upgraded.

However, Turkey is perceived as the most politically and economically unstable country covered by *Emerging Trends Europe*, and it is clear that respondents feel political risk has increased since the attempted coup in July 2016 and in the light of its position bordering Syria.

“In Turkey, we are highly affected by political instability as regards to processes,” says one interviewee. “Fortunately, we are not involved in Turkey, or we would withdraw now,” says a pan-European fund.

There are still cross-border investors operating in the country, but others are voting with their feet. Last December, after 10 years in Turkey, Dutch-listed Vastned wrote down the value of its Istanbul retail portfolio and sold it to a group of local private investors.

Retail and tourism are seen as particularly vulnerable, with the Turkish lira adversely affected by the strengthening euro, inflation at around 11 percent and declining consumer spending. A Turkish developer says: “We are avoiding new real estate investments in tourism and retail markets, which are the sub-markets most affected by economic and political uncertainties in the country.”

Instead, he adds: “We plan to make new investments in the residential sector, where there is government support and urban transformation.” Others investing in new residential and student housing include a joint venture between Turkish private equity firm Intus Capital and developer Nef, which won backing from the European Bank for Reconstruction and Development.

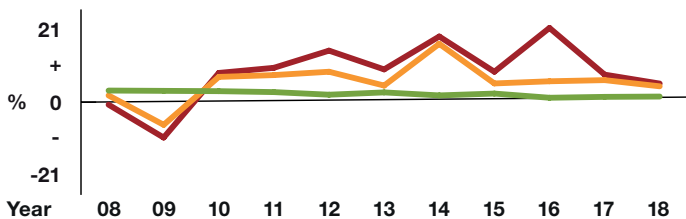
Local investors interviewed are resigned to operating in a challenging environment for the next three to five years. In this climate, “one of the biggest opportunities is the availability of distressed assets”, one says.

Population, employment and disposable income per capita, 2018



Source: Moody's Analytics

Population, employment and disposable income per capita, annual change 2008–2018



Source: Moody's Analytics

Note: Income for Istanbul is real wages and salaries, not disposable income

All-property return, 2008–2016

MSCI does not produce an index for Istanbul.



“Densification and urbanisation will cause more city growth. Employment will be consolidated. Everything related directly or indirectly to transportation, health, energy and waste will be the future.”

Chairman, UK developer

“We are looking at the blurring of boundaries between residential and commercial as a result of the trend towards people moving back into city centres into more of a live/work setting.”

Director, German fund manager

Chapter 4

Rethinking real estate



From space-as-a-service to the growing use of data analytics, disruption is all around us. The changes are ushering in new business models and heightening complexity and risk. Although the end-state remains uncertain, new strategies and capabilities are needed now to compete, while laying the foundations for the future. So, what does it take to stay relevant in this fast-shifting real estate landscape?

As social and technological disruptions gather pace, more and more businesses are using new tech-enabled capabilities and openings created by changes in customer behaviour to reach out beyond their traditional boundaries. Telecoms firms have evolved into entertainment businesses, and automotive companies are eyeing a future where they facilitate mobility, such as car or rail on demand.

Emerging Trends Europe reveals that real estate is heading down the same road. While physical space and location are still the foundations around which value is created, shifts in customer expectations are changing what is required from the space and its surrounding environment. “A building is a building,” says one developer, but the sector is facing “a lot of complexity” and “we’re all on a learning curve”.

In last year’s report, we asked industry leaders what kind of sector landscape they expected to see within a 2030 timeframe. It is clear from this year’s survey that much of what they anticipated for 2030 is already happening, challenging long-held assumptions about the nature of real estate and how value is created within the sector. So, what are the key features of the new landscape, and what does it mean for strategies and operations?

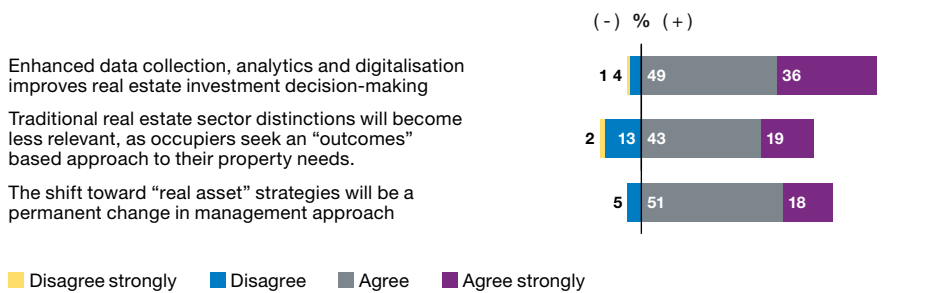
Figure 4-1 Emerging trends ... 2030



Source: *Emerging Trends Europe* survey 2018

Answers to the question: "What do you consider will be the biggest trend impacting real estate between now and 2030?"

Figure 4-2 **Changing how the real estate industry operates**



Source: *Emerging Trends Europe survey 2018*

“Changes in the way we organise our professional and personal lives will change the relationship and priorities regarding work spaces and the concept of housing.”

Director, pan-European fund manager

Blurred lines

What is evident now is renewed enthusiasm for mixed-use developments that combine residential, recreational, commercial and cultural uses. The single-use residential blocks, suburban office districts and out-of-town shopping centres, which were geared to automobile access and have been the norm in most of our lifetimes, are increasingly seen as outmoded forms of development.

One of the key drivers for the return of mixed-use development is the blurring of the boundaries between professional and personal lives in today’s hyper-connected world. From a real estate perspective, this is more than just a move towards hot-desking or more flexible working patterns. Now that people can work anywhere, what would once have been their workplace is now where they come to engage, relax and live, as well as work.

With buildings expected to meet multiple demands, and their occupants wanting more flexible tenancies, the outcomes-based, space-as-a-service model has emerged. This has strong echoes of the move to on-demand content seen in entertainment. Examples of these innovations in real estate include Amsterdam’s Zoku (Japanese for family, tribe or clan), which offers both short-stay options for mobile professionals and longer-term home/office apartments, along with common areas to eat, co-work and socialise. WeLive, the new venture from the founders of WeWork, offers studios and apartments, along with shared facilities ranging from laundry rooms that double as bars and event spaces to communal kitchens, roof decks and hot tubs. People can stay for a few nights or sign longer leases.

“The workspace has to be simplified in format, has to be more cost-effective, because it is competing with everything – coffee shops, the home – in a way that, with wifi technology improving as it is, the barriers to the movements of employment are coming down in spades.”

Senior partner, UK consultancy

This mixed-use trend can also be seen in the cinemas, restaurants, food outlets, medical centres and even co-working spaces that are becoming a common feature of today's shopping centres. The aim has changed from providing a one-stop-shop to attract customers towards creating a compelling experience. The experience should not only make shopping more appealing, but help to project the retail brands and hence promote online as well as on-site sales.

And this brand showcasing can just as easily occur in a rail station, airport or hotel lobby. Connectivity eliminates the distinction between virtual and physical real estate – people can see the product in the hotel lobby and then buy it or send “likes” to their social media friends.

“Brands sold online are using retail centres as a showcase for marketing, which strengthens prime locations.”

Head of CEE at global consultancy

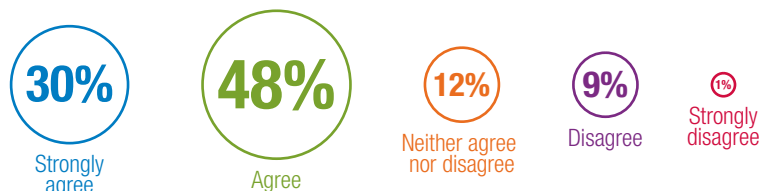
Disruptive forces already at work in real estate

While technology is evolving at a phenomenal rate, it is the social trends and shifts in human behaviour, which many *Emerging Trends Europe*

interviewees believe are doing most to drive innovation and change in real estate.

| | | |
|----------------------------|-------------------|---|
| New entrants | Google | Plans to build a city “from the internet up” |
| | Facebook | Plans to create mixed-use campus town |
| New partnerships | Moda Living/Uber | Reduces the need for tenants to have private cars |
| | Airbnb/Newgard | Enables long-term tenants to sublet apartments easily |
| New business models | Amazon/Wholefoods | Acquisition opens up access to physical, urban retail/distribution |
| | Amazon/Greystar | Installs locker systems in residential properties, consolidating deliveries from multiple operators |
| | SoftBank/WeWork | Tech fund invests in real estate business |
| New products | OVG | Real estate developer offers tech-enabled, sustainable buildings |
| | Zoku | Offers short-stay options, long-term home/office and community living |
| | Il Centro | Turns conventional retail into an experience, social centre and brand showcase |
| | The Collective | Creates service-based spaces where people can live and work |

Changes in ways of working, mobility and lifestyle will lead to more densification in cities



“Urbanisation is an opportunity, but it is also a high risk if you don’t solve the affordability issue at the same time.”

Head of Research,
German investment manager

“I will not buy a building if I can’t walk to it.”

Head of Spain & Portugal at global investment manager

Density intensifies

Alongside the rise of mixed-use development, the design focus around cars is giving way to more sustainable approaches as the influx into cities intensifies the pressure on transport infrastructure and available space. *Emerging Trend Europe’s* survey indicates a strong consensus that densification will continue, reflecting lifestyle and employment trends as much as transport or environmental drivers. For real estate players evolving their strategies, this consensus feels like an important point of clarity in an increasingly uncertain and disrupted industry. Smart densification and its impact are likely to remain fundamental and enduring strategic considerations for the real estate industry. And a key part of this is promoting and developing more sophisticated approaches to “good density” (cohesive, connected, sustainable and plenty of open space) and avoiding “bad density” (isolated, monotonous and poorly planned and designed single-use developments)¹.

One of the main spurs for densification is people’s desire to be where it is all happening; this is encouraging multiple demographic cohorts (not just millennials) and the businesses that want to employ and serve them to cluster in urban centres. Shared space is as important as private space in cities today, even if this means that where people live and work is more confined. In turn, how the building is used is becoming as important as the building itself.

Yet higher density comes at a cost – transport systems are struggling to cope and even though people demand less private space, key workers risk being priced out of city centres. These challenges are leading to the recognition that real estate, in all its forms, is only as viable as the infrastructure to support it.

Indeed, according to *Emerging Trends Europe*, real estate is itself increasingly seen as a form of infrastructure – a city needs the right mix of affordable residential and business accommodation as well as the right mix of transport facilities to function effectively. For investors, the interplay between real estate and infrastructure is opening up a new range of “real asset” opportunities².

¹ The characteristics of good bad density are explored further in ‘Density: Drivers, Dividends and Debates’, Urban Land Institute, June 2015 (<https://europe.uli.org/density-drivers-dividends-debates/>).

² We explore the emergence of real assets and their impact on investment strategies in ‘Emerging Trends in Real Estate - The Global Outlook 2017’ (<https://www.pwc.com/gx/en/industries/financial-services/asset-management/emerging-trends-real-estate/global-outlook-2017.html>).

Figure 4-3 The changing face of real estate



Source: Emerging Trends Europe survey 2018

“Changing behaviour of people is driving the sector to omni-use developments rather than mixed-use developments, meaning facilitating the need for people to be able to work anywhere, shop anywhere on- and off-line and to relax anywhere.”

Director, pan-European consultancy

Driven by both commercial reasons and pressure from city authorities, the industry is responding to the challenges of densification with more innovation and collaboration across real estate sectors.

These forces are driving new approaches to city logistics. Amazon recently started collaborating with residential landlords such as Avalon Bay and Greystar to install locker systems in their sites. This innovation is symptomatic of a more “outcomes-focused” approach in an increasingly customer-driven industry; it responds to both the desire for fast delivery and the fact that residential operators have struggled with increasing mailroom traffic. The lockers are also used for non-Amazon deliveries, providing both a valuable service to residents and lower costs for “last-mile” delivery.

Multiple deliveries can of course increase congestion, so a notable feature of the planning conditions for London’s 22 Bishopsgate development is the requirement for an off-site delivery centre, where individuals’ and business goods will be consolidated to minimise vehicle movements to the site.

Competition for space is also providing the catalyst for developments that combine residential and commercial space on the same site, such as the co-live/work The Collective and the “beds and sheds” collaboration between Segro and Barratt London.

Eventually, the demarcations between different types of development and developer may disappear altogether as mixed-use paves the way for omni-use complexes in which people live, work and play within the same seamlessly connected environment. The broad strategy embraced by Unibail-Rodamco exemplifies this trend. While the company still sees its focus as shopping and convention centres, it is seeking to create a diverse and integrated environment in projects such as its southern Überseequartier in Hamburg’s HafenCity, which includes a new cruise terminal as well as retail, catering, residential and entertainment uses.

Higher profile

Cutting across all these trends is the realisation that real estate plays a critical role in meeting society's changing needs and challenges – arguably as important as hospitals, rail networks and other essential services to the wellbeing and fabric of society and economic success. The consequences are reshaping real estate in areas ranging from its emergence as a mainstream service provider to the increased profile of the industry and the brands within it.

“Organisations like us now have to demonstrate that they are contributing to the society which produces the environment that supports their success. That potentially threatens those who don't keep up.”

Finance director, global investment manager

One example of a company acknowledging this shift is OVG, the Dutch developer behind The Edge in Amsterdam, one of the world's most sustainable office buildings. Based on its experience with The Edge, OVG is refocusing its business model from traditional developer to a provider of tech-enabled, highly sustainable buildings, focused on an enhanced experience and additional insights for tenants and end-users.

Eventually, users of real estate may become as brand-conscious as sectors such as telecoms or retail, with people and organisations making location and property choices increasingly based on the brand strength of the business owning and operating the real estate.

Will the celebrated industry icons of the 2030's include the CEOs of a new generation of technology-rich property companies who anticipate both the “hardware” and “software” real estate needs of customers? There are clear advantages to such prominence. These include opportunities to set trends in how consumers live, work and play, rather than just following them, in the same way as brands like Apple. There would also be greater opportunities to participate in the public debate over urban priorities and planning, work in partnership with government and ensure the industry's voice is heard. However, this changing role also increases real estate's social and environmental responsibilities, heightens public scrutiny and raises the associated reputational risks.

Dealing with complexity

In the past, investors and developers could design and create the space, negotiate a long lease and then benefit from steady long-term returns. Is this model still viable? Now, tenants want shorter and more flexible terms, customer outcomes are the primary driver of value and real estate is becoming a service rather than a passive asset. Moreover, while the development cycle is still as long and capital-intensive as ever, the yield is riskier and more volatile. How can investors and developers deal with such imbalances and complexities? Describing the big challenges facing her business, one global investment manager points to a disruptive cocktail of “speed of change, blurring of boundaries between sectors, and managing increasing complexity to create investments” as well as the “pressure from capital looking for good investments as a result of the shift to ‘real asset’ strategies”.

“Increased complexity allows you to add more value via the operational layer. But it also makes it harder to access and therefore, arguably less liquid. There's a lot of institutions that do not like that.”

CEO, Nordic fund manager

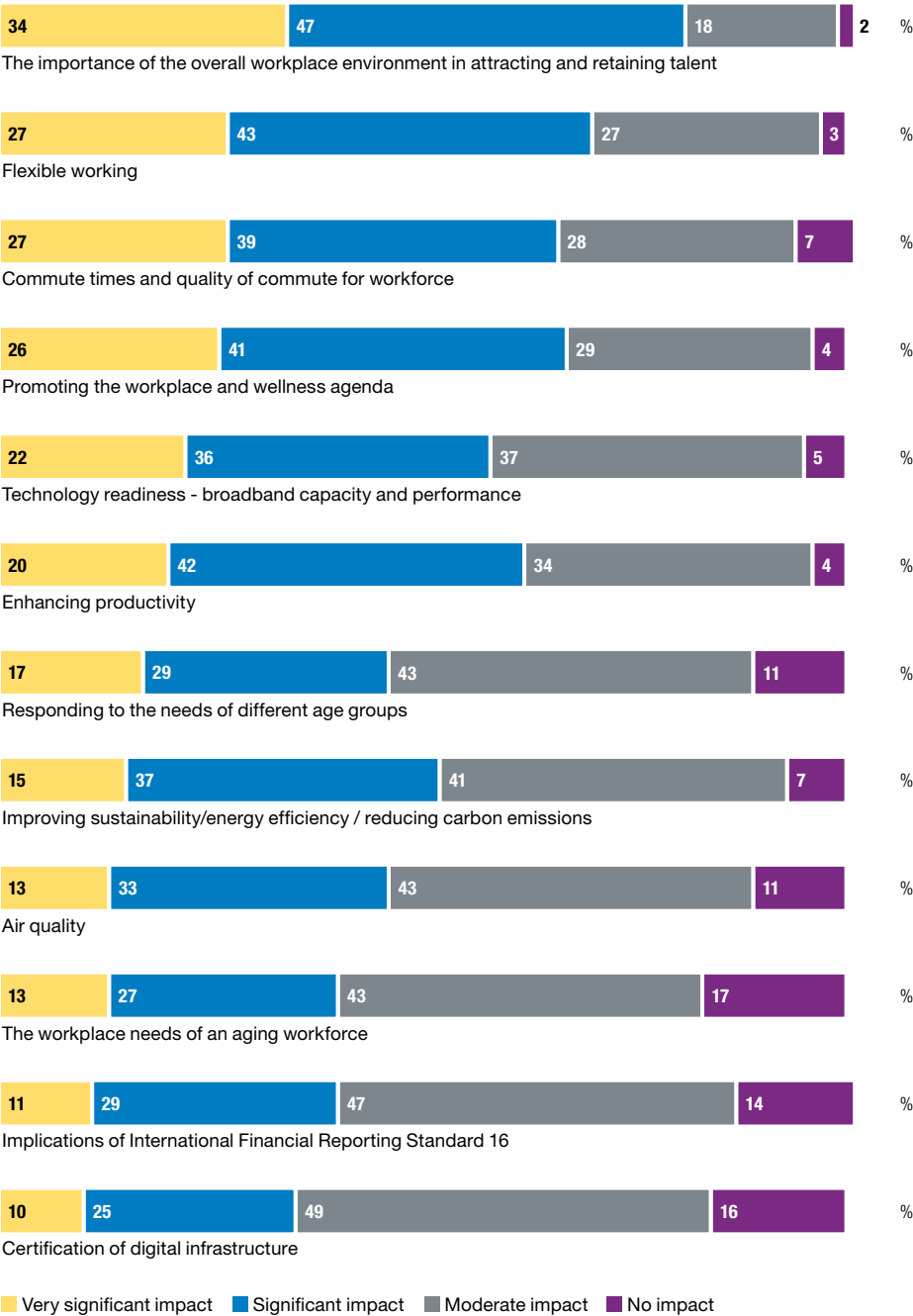
New customer demands and associated business models such as space-as-a-service require more diverse skillsets. And this does not just apply to service companies, but also to investors and developers as the dynamics of real estate come to resemble those of complex, outcomes-focused industries. Key skills include the analytical capabilities needed to make the most of a profusion of real estate “performance” data collected from the users of buildings, the buildings themselves and the surrounding environment. Many of the executives we spoke to are already using or experimenting with big data to improve their decision-making and management. This includes hiring environmental scientists and even sociologists to support customer demand and investment analysis.

The results are not only being used to strengthen customer understanding and satisfaction, but are key elements of new approaches to investment, which combine traditional valuation methods with customer data in areas such as tenant satisfaction, environmental performance, health and wellbeing. From professional training to performance management, a clear understanding of these metrics and their implications are set to be essential elements of how real estate operates.

“Digital technology is changing the industry and behaviours of owners, occupiers and managers. This time around, real estate will not dodge the technology bullet.”

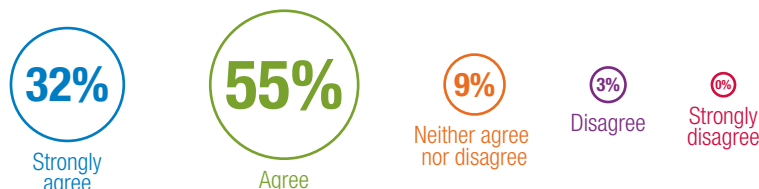
Director, German fund manager

Figure 4-4 Factors influencing real estate strategies over the next 3-5 years



Source: Emerging Trends Europe survey 2018

Institutional investors need to develop new and diverse skill sets in the new world of “space as a service”



“We have put together a dedicated analytics team to really put our arms around the data we have got and use that a lot better to recognise trends early and price investment decisions.”

Head of EMEA, global investment manager

And it is not just skills that are needed, but a rethink of what real estate is and how it delivers value. Many of the businesses in the vanguard of this movement, and those developing the necessary capabilities to compete, are “PropTech” entrants. Partnering with or acquiring such businesses can provide an important source of skills and access to new and evolving markets, such as Union Investment’s acquisition of a stake in Architrave, a data management business. Another example is data analytics platform GeoPhy and pension investor PGGM’s collaboration to derive alternative “quality scores” for assets in its real estate portfolio.

As with parallel investments in technology, however, PropTech acquisitions can be expensive and are not without risks. Industry leaders canvassed by *Emerging Trends Europe* raise some concerns here, pointing to the need to ensure that investment meets defined strategic needs, rather than just being part of the rush to become tech-enabled.

The pace of change and the openings that come with technology are reflected in a strong sense of urgency and excitement across the interviews conducted for this report. These shifts also heighten complexity and risk, however. The once clear and linear invest, design, build and let model is giving way to an industry with more moving parts and more moving targets. So, what does the future look like, and what are the key capabilities needed to compete?

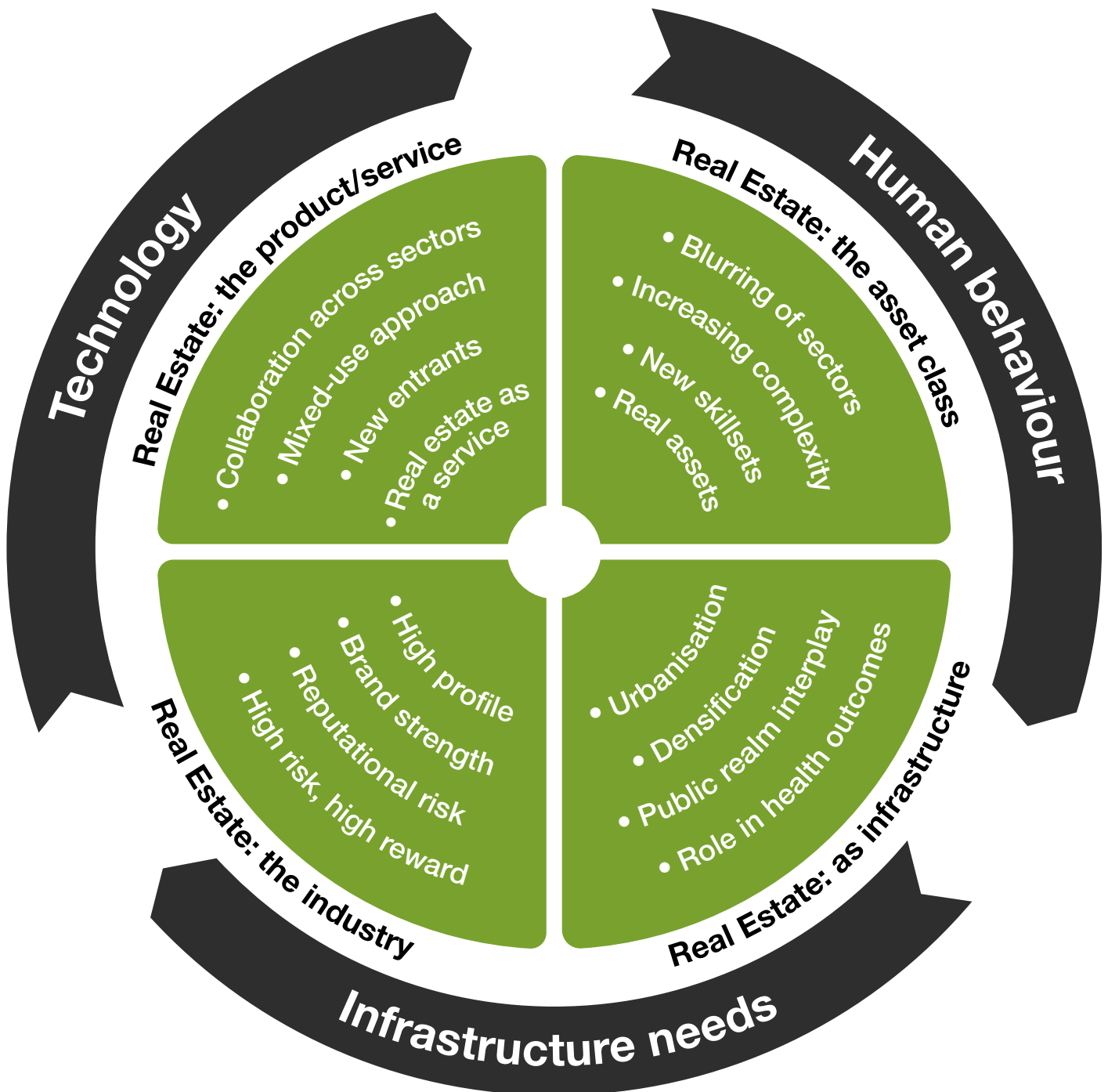
“Increasingly we are talking about health and well-being, about air-quality, filtration systems, particularly in cities like London and Paris.

There is concern about nitrogen dioxide – it may not be long before people have wearable pollution monitors and employees can tell you where they want to work.”

CEO, UK fund manager

Rethinking real estate

Changing human behavior, technology and the evolving needs of the built environment are driving a rethink of the world of real estate from four different perspectives: its nature as a product/service, as an investment asset class, as part of society's critical infrastructure and as an industry sector.





About the survey

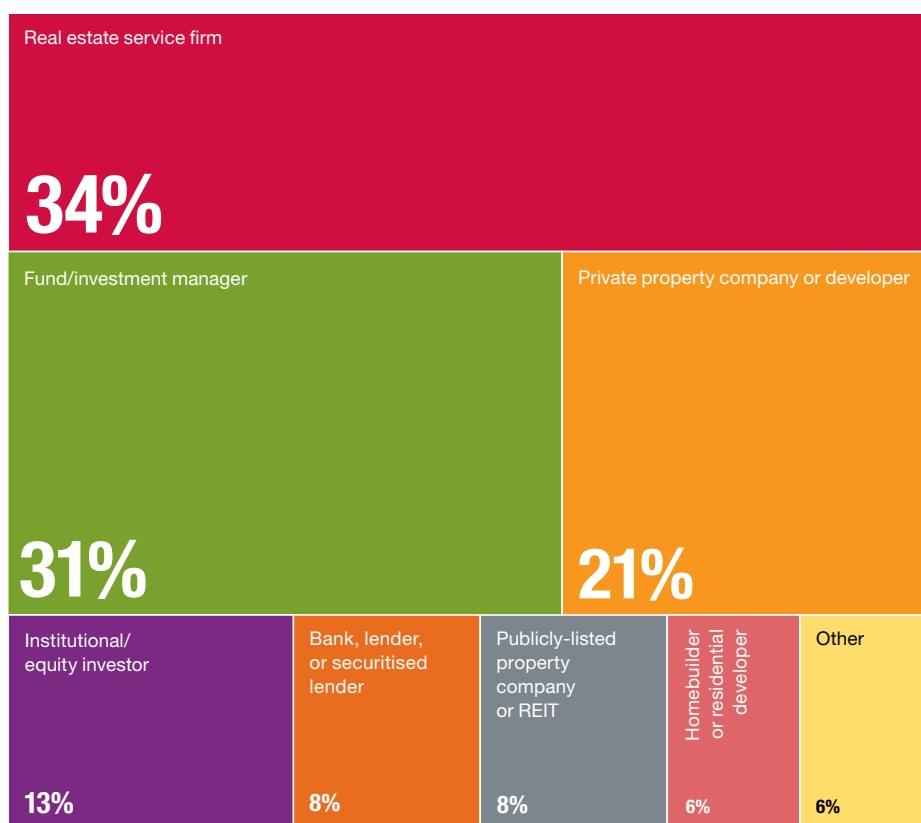


Emerging Trends in Real Estate® Europe, a trends and forecast publication now in its 15th edition, is a highly regarded and widely read report in the real estate industry. Undertaken jointly by PwC and Urban Land Institute, the report provides an outlook on real estate investment and development trends, real estate finance and capital markets, cities, property sectors and other real estate issues throughout Europe.

Emerging Trends in Real Estate® Europe 2018 reflects the views of 818 individuals who completed surveys or were interviewed as a part of the research for this report. The views expressed, including all comments appearing in quotes, are from these surveys and interviews 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, advisers and consultants.

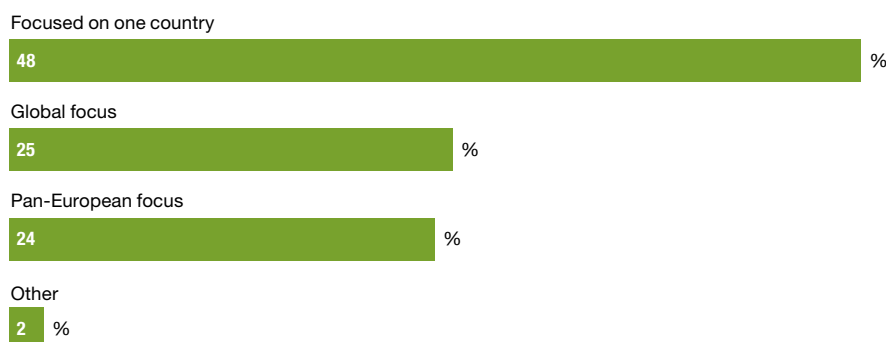
A list of the interview participants in this year’s study appears on the following pages. To all who helped, ULI and PwC extend sincere thanks for sharing valuable time and expertise. Without their involvement, this report would not have been possible.

Survey results



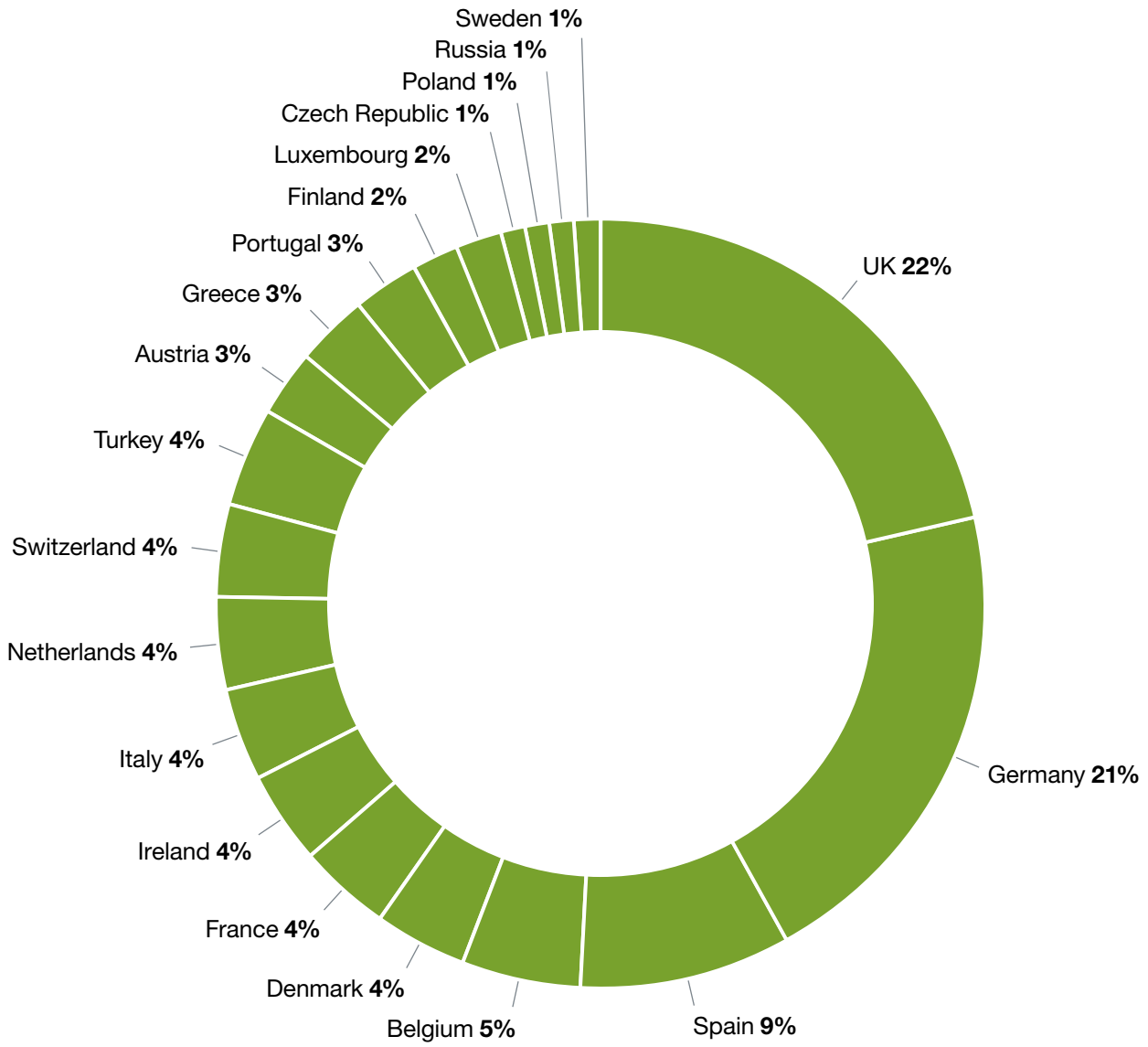
Source: *Emerging Trends Europe* survey 2018
 Note: Respondents could choose more than one category, so percentages do not add up to 100.

Survey responses by geographic scope of firm



Source: *Emerging Trends Europe* survey 2018

Survey responses by country



Source: *Emerging Trends Europe* survey 2018

Interviewees

Activum

Carlos Molero

ADEQAT Investment Services

Herbert Logar

Aedifica

Laurence Gacoin

AEW

Massimiliano Bernes
Cyril Hoyaux
Patrick Meutermans

Afiaa

Ingo Bofinger
Bardo Magel

AG Real Estate

Serge Fautre

AgFe

Natalie Howard

AIB

Paul Kelly

Allianz

Philippe Jonckheere
Mauro Montagner
Miguel Torres
Francois Trausch

AM

Ronald Huikeshoven

Amundi Immobilier

Jean-Marc Coly

AND Gayrimenkul

Ali Baki Usta

Annexum

Huib Boissevain

Antilooppi

Antti Savilampi

Antirion

Giorgio Pieralli

APF International

Wiggert Karreman

APG

Paul Atema
Robert-Jan Foortse

Apollo Management Advisors

Roger Orf

Ardian

Bertrand Julien-Laférierre

Ardstone Capital

Donal O'Neill

Art Invest Real Estate

Dr. Markus Wiedenmann

ASR Real Estate

Rodney Zimmerman

Atrium Ljungberg

Martin Lindqvist

Avara

Harri Retkin

Aventus Capital Partners

Mark Donnelly

Aviva Investors

François Grandvionnet

AXA Investment Managers - Real Assets

Nathalie Charles
Rainer Suter

Balmain Asset Management

James Turner

Bank of America Merrill Lynch

Kari Pitkin

Barings

Hanna Rauhala

Bayerische Versorgungskammer

Norman Faekelmann
Rainer Komenda

BBVA

Gonzalo González
Juan Ortueta

Bei Capital

Collin Lau

Belfius

Annemie Baecke

Beni Stabili

Alexei Dal Pastro

Benson Elliot

Trish Barrigan
Gregg Gilbert
Marc Mogull

Berlin Hyp

Assem El Alami

BIG

Daniel Thum

Bilfinger

Thomas Leinberger

Blackrock

Marcus Sperber

Blackstone

Anthony Myers

BMO Real Estate Partners

Iris Schöberl

BNP Paribas Real Estate

Laurent Boissin
Barbara A. Knoflach
Andy Martin
Carsten Stork

Bonnier Fastigheter

Thomas Hermansson

Borio Mangiarotti

Edoardo De Albertis

Bouwinvest

Marleen Bosma

Brevast

Dino den Hollander

Brink Groep

Hans De Jonge

Brioschi Sviluppo Immobiliare

Matteo Giuseppe Cabassi

British Land

Lucinda Bell

Bruntwood

Chris Oglesby

CA Immobilien Anlagen

Frank Nickel

Capital & Counties Properties

Ian Hawksworth

CapMan

Sampsa Apajalahti
Markku Jääskeläinen
Mika Matikainen
Per Tängerstad

Castello

Giampiero Schiavo

Catella

Timo Nurminen

CBRE Global Investors

Loes Driessen
David Hendrych
Jeremy Plummer
Antonio Roncero

Cerha Hempel Spiegelfeld Hlawati

Manfred Ton
Peter Vcelouch

Citycon

Marcel Kokkeel

Codic

Raphael van der Vleugel

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Lisette van Doorn

Chief Executive Officer
Urban Land Institute Europe

Anita Kramer

Vice President
ULI Center for Capital Markets and Real Estate

Dr Elizabeth Rapoport

Content Director
Urban Land Institute Europe

www.europe.uli.org

Editors, authors and project team

Gareth Lewis, *Emerging Trends in Real Estate® Europe*
Project Leader

Alex Catalano, Co-Editor

Doug Morrison, Co-Editor

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Emerging Trends in Real Estate[®] Europe 2018

Emerging Trends in Real Estate®

Europe 2018

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