Emerging Trends in Real Estate®

Beyond the capital

Europe 2016

Contents

Cover image: Marie-Elisabeth Lüders Building, Berlin, Germany

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A publication from PwC and
the Urban Land Institute

Executive summary

Capital flows and city rankings will always attract the headlines, but this year *Emerging Trends Europe* shines a spotlight on fundamental changes at the business end of the real estate industry. It reveals an industry trying to come to terms with the needs of occupiers and the disruptive forces of technology, demographics, social change and rapid urbanisation.

These ground-level disruptions are permeating through the entire real estate value chain. Investors are focused on cities and assets rather than countries. They also favour alternative, more operational assets for accessing outperformance, with 41 percent of respondents against 28 percent last year considering taking the plunge into alternatives. Healthcare, hotels, student accommodation and data centres are all expected to shine as sectors benefiting from urbanisation and long-term demographic trends.

Development is seen as another way to achieve outperformance in 2016, with 78 percent agreeing it is an attractive way to acquire prime assets. The more progressive developers and investors are innovating – attempting to anticipate and adapt to rapidly changing occupier demands. Those canvassed by *Emerging Trends Europe* hold polarised views on issues like optimal lease lengths, shared office space and the impact on established valuation models and traditional assessments of covenant strength.

Low interest rates and the sheer weight of capital bearing down on European real estate mean that most remain bullish about the industry's business prospects in 2016. However, concerns over geopolitical issues like immigration and terrorism, Britain's potential exit from the European Union, economic decline in China and uncertainty over Europe's economic recovery, have led to a strong undercurrent of caution, most obviously highlighted by lower levels of confidence in the outlook post 2016.

According to *Emerging Trends Europe*, the five leading cities for investment prospects in 2016 are Berlin at Number 1, followed by Hamburg, Dublin, Madrid and Copenhagen. Many interviewees back the German capital to thrive well beyond 2016, based on its young population and its growing reputation as a technology centre, as well as the land available for development.

The vast majority of respondents are confident in their ability to thrive in 2016. However, they acknowledge it is an increasingly competitive global field for real estate. They are aware that if the wall of capital recedes, European markets could be left exposed. Then it will be the strength of the underlying market fundamentals and management's operational skills that come into focus.

Which brings us back to occupiers. The clear challenge to the industry is to be less about bricks and mortar and more about service. As one interviewee concludes: "Twenty years ago we had tenants, now we have customers. In 20 years' time we'll have guests."

Chapter 1

Business environment

"Business is good: value is there for the right deals. However, we fully expect there to be shocks to the system along the way."

Europe's real estate industry is very optimistic about its business prospects in 2016, albeit slightly less confident than it was a year ago. Over half of the property professionals surveyed by *Emerging Trends Europe* indicate that headcounts will be static, and while profit expectations are slightly down on 2015, very few – 7 percent – expect to do worse.

"Europe looks well set," concludes one global investor. "There is an improving macro-economic picture, unemployment is improving, supply has been minimal for many years, and banks and investors are finally becoming active in terms of cleaning up their balance sheets and selling assets. That is creating a lot of interest."

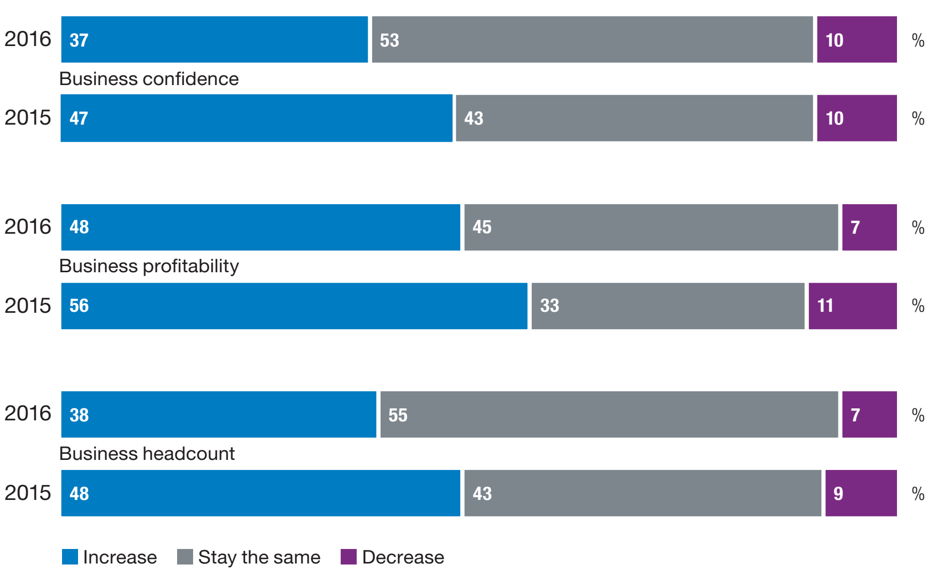
One reason for such a relatively benign view of European markets in 2016 is that, against a backdrop of continuing low interest rates, the difference between real estate and bond yields remains attractive. "Everybody wants to increase allocations to real estate because it offers returns that you cannot achieve with a similar risk level in bonds."

"Everybody wants to increase allocations to real estate because it offers returns that you cannot achieve with a similar risk level in bonds."

The sheer weight of capital bearing down on European real estate has once again boosted business for many of those canvassed for this year's report. And as many as 87 percent of them believe that global capital flows will continue to influence their investment strategy over the next five years.

"There is a continuing appetite for real estate, and that demand is coming from a pretty broad spectrum of investor types – pension funds, retail investors, wealth management, sovereign wealth and the larger insurance companies."

Figure 1-1 **Business prospects in 2016**



Source: *Emerging Trends Europe* survey 2016
Note: Percentages may not total 100 due to rounding

The most bullish about their business in 2016 are respondents from Southern Europe. No doubt this comes from a very low base, but none the less reflects economic recoveries in their countries. Spain particularly is increasingly seen as a destination for mainstream investors rather than opportunistic capital.

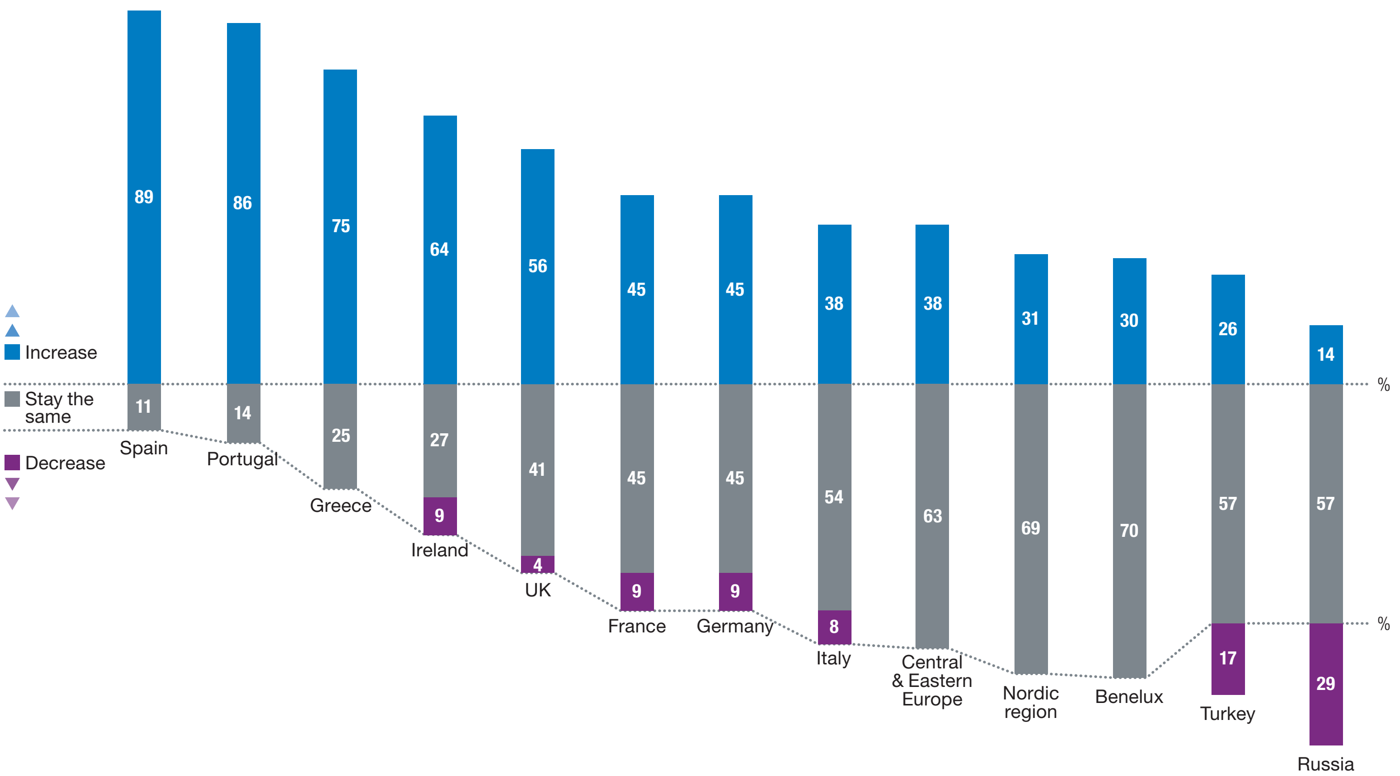
Last year respondents in Ireland were the most confident in Europe about improving profitability and they remain upbeat for 2016, as this one-time distressed market returns to normality.

UK-based respondents, meanwhile, have benefited hugely from being part of Europe's strongest economy and biggest property investment market; over half of them expect to increase their profits in 2016. In interview, however, the UK contingent is more circumspect.

They are aware that their market is further through the property cycle than anywhere else in Europe. The CEO of one REIT puts it bluntly: "We have been de-gearing since the end of 2014 when we committed to our last speculative development. If you think the market is going to go up, gear your balance sheet. If not, de-gear."

At the other end of the scale is Russia. Last year two-thirds of Russian respondents predicted a decline in fortunes. This time, just less than a third say things will get worse in 2016, which is progress of sorts, but still grim. "It's about survival," says one.

Figure 1-2 **Business profitability in 2016**



Source: *Emerging Trends Europe* survey 2016

"The last three or four years it's just been a straight line going up, and that is not the case now."

But for the Eurozone, a key indicator for 2016 can be gleaned from the fact that business sentiment in both Germany and France is evenly split between those who believe they will do better in 2016 and those who expect it to be the same as 2015. Says a German lender: "We are positive but not outright bullish; there is a good number of deals to be done. The last three or four years it's just been a straight line going up, and that is not the case now."

No-one expects unbridled growth. There is a significant undercurrent of caution across Europe as a result of geopolitical issues, political uncertainty and economic decline elsewhere, all of which could escalate and impact on real estate. Last year's concerns over Greece and the break-up of the Eurozone have eased for now, but only to be replaced by the possibility of Brexit.

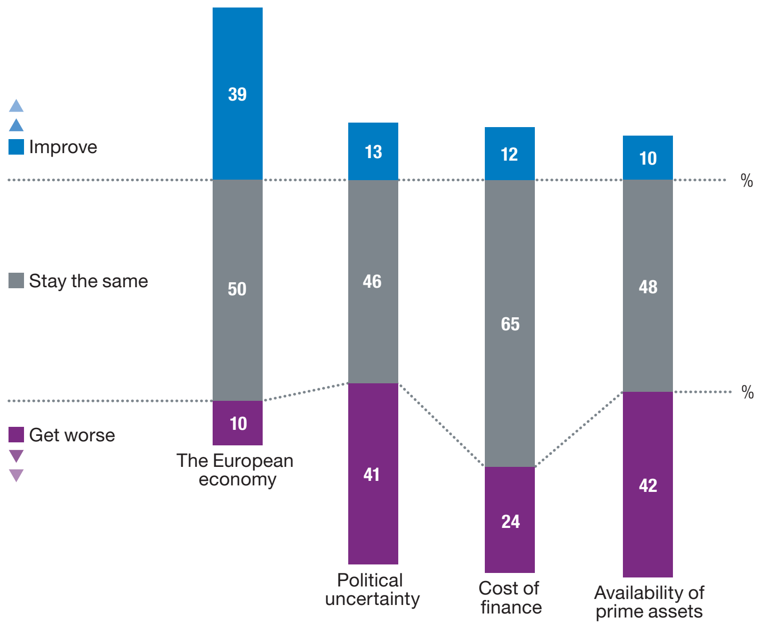
The global oil glut has sent oil prices plunging, and with this a likely cut in allocations to real estate from some oil-producing states. Russia's conflict with Ukraine remains a threat to the region. And Middle Eastern conflicts have led to terrorist attacks in Paris and the mass movement of people into Europe, on a scale not seen since the Second World War.

"Everybody has become a sideline economist and politician," says a banker. "You have to be aware of what's going on because the windows to do things have become so much tighter, and the volatility in the markets moves so rapidly. In the public markets you have to be careful. In the private markets you have to have a view."

Figure 1-3 **Real estate investment in European countries, Q4 2014–Q3 2015 (€ billion)**

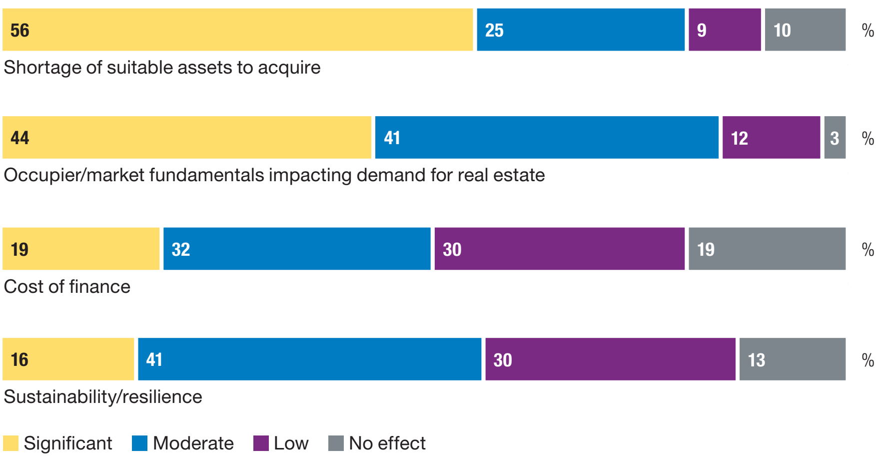
Source: Real Capital Analytics

Figure 1-4 **European business environment in 2016**



Source: *Emerging Trends Europe* survey 2016

Figure 1-5 **Issues impacting business in 2016**



Source: *Emerging Trends Europe* survey 2016

Shortage of assets

In some respects, the outlook for 2016 suffers by comparison with 2015 – how can such extraordinary investment be sustained? "The climate is good now but we think the market will gradually become more expensive and opportunities will narrow. Windows are already closing," says one fund manager.

So while 39 percent of survey respondents expect the European economy to improve in 2016, it is not enough to eradicate the disconnect between capital flows and somewhat shaky occupier demand. "People are investing not on the expectation of rental growth but just because of low interest rates and the perception that real estate is a safe haven," says a German interviewee.

One pan-European investor points out that "weight of money can increase values, but it can't increase rents", adding: "People keep justifying Spain on the fact that it has had four quarters in a row of GDP growth but actually it also has had quite a few months of deflation. And that could well feed through to rents."

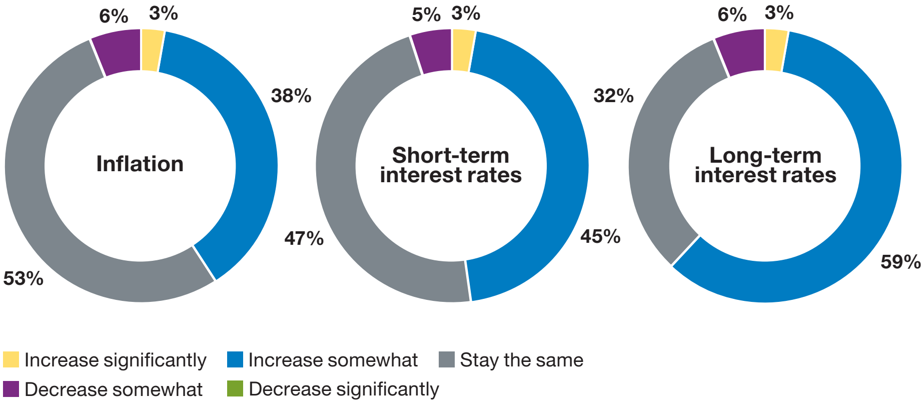
However, most of *Emerging Trends Europe*'s constituency is more concerned about deploying capital in 2016. "Because of geopolitics everyone is looking at countries like Germany, the Netherlands and the UK, and there is an overload of capital. We are not comfortable with the price of core assets," says one Dutch institutional investor.

"We are close to the top … the end of the yield compression story."

All across Europe, the industry is complaining about the continuing lack of prime assets, and over 40 percent of respondents expect availability to get worse; pricing is a worry. "We are close to the top … the end of the yield compression story," the CEO of a London-based REIT says. In Belgium, one developer warns: "The market is overheating. We have offices at 4 percent now. Prices are very high. One has to be careful."

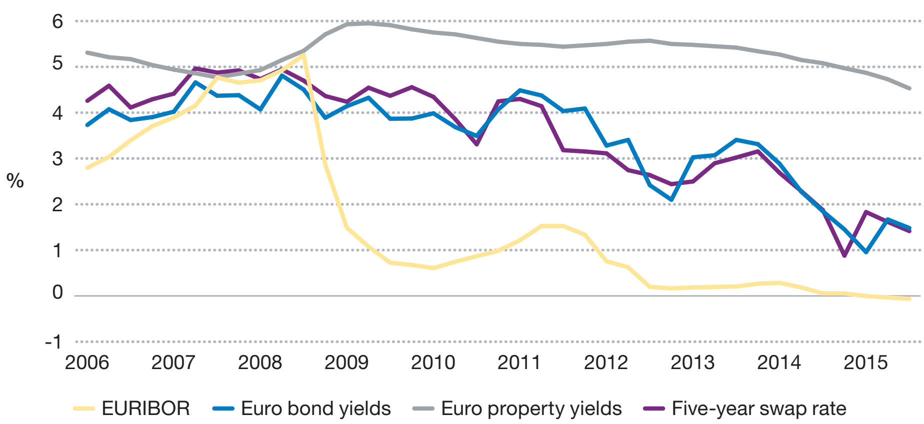
However, no-one is predicting a downturn: "For the next 12 months I think it's going to be the same; things will be expensive and maybe even get more expensive. But it doesn't feel stupid like it did in 2006 and 2007."

Figure 1-6 **Interest rates and inflation in 2016**



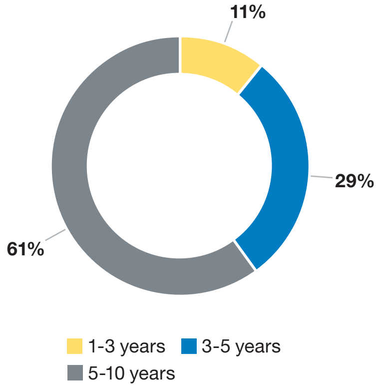
Source: *Emerging Trends Europe* survey 2016

Figure 1-7 **Eurozone property yields and interest rates, 2006–2015**



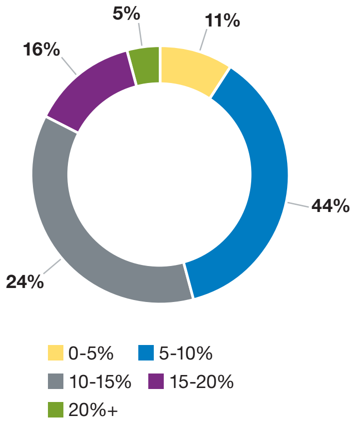
Source: CBRE, Datastream, European Central Bank, ICE

Figure 1-8 **Time horizon for holding investments**



Source: *Emerging Trends Europe* survey 2016

Figure 1-9 **Returns targeted in 2016**



Source: *Emerging Trends Europe* survey 2016

The search for returns

One of the running themes in *Emerging Trends Europe* over recent years has been the shift of opportunistic capital into the region's distressed markets – first the UK, then Ireland and Spain. The narrative has become more complex, and many now believe the big movements by these players are over.

That's not to say sales of distressed assets are at an end. One UK interviewee suggests: "There is still some way to go for banks 'right-sizing' their loan books and this will drive more asset sales, particularly retail."

Or as one global fund manager puts it: "I don't think there are any actually distressed markets in Europe. There are markets in different stages of recovery."

To that end, Spain still attracts much attention, but with the scrutiny now on underlying tenant demand. "The Spanish economy shows an upward trend, and for the first time since 2007, macroeconomic fundamentals point towards a recovery," says a supporter.

Signs of investors diverting their attention from Spain to Italy were already evident last year and that trend is intensifying, again with property fundamentals to the fore.

"The distinction with Italy is that it was never built on a strong dosage of debt so the wheels didn't come flying off quite as abruptly. And northern Italy is an economic powerhouse and really quite an interesting market."

Similar judgment calls are being made on other recovering markets, even selectively in Central and Eastern Europe. As a Czech investor points out: "We are seeing occupancy in our buildings going up and quite good demand from tenants. We are seeing the banks being much more willing to lend on new acquisitions as well as refinancing existing portfolios. Barring any economic disasters, we think that will carry on."

For all the attractions of recovering markets, the majority of investors are settling for relatively safe, modest returns by deploying capital into core real estate in major cities. That trend will continue through 2016. As one US player puts it: "We see continued strength in the mature world – the US and Europe – with a huge degree of capital seeking high-quality real estate. The emphasis should be placed on 'high quality'. In general, the investment world is concerned looking forward, and has fairly low return expectations, which explains what's going on in the real estate space."

This suggests that European real estate will remain a safe haven for some time yet. Investors do not appear to have lowered their targeted returns for 2016, compared to what they indicated in the 2015 survey.

Another global investor concludes: "Factors like what is happening in emerging markets and political volatility can have an impact, but the signals are that the sustained appetite for what the asset class can offer isn't going to change. Fundamentally, real estate appeals to investors for a diverse range of reasons that won't diminish over the next 12 months."

Top trends

Logistics rules

One of the most vibrant sectors identified by *Emerging Trends Europe* over recent years has been logistics, largely on the back of rapid growth in online retail sales.

Some are viewing logistics as a proxy for retail property, but less highly priced based on its location.

There was a veritable stampede of capital into the sector during 2015 and the signs are that there will be more of the same in 2016.

Prime assets are overpriced

"We see a very strong capital flow and bigger allocations to logistics," says one specialist player. "Logistics is becoming an institutional investor product."

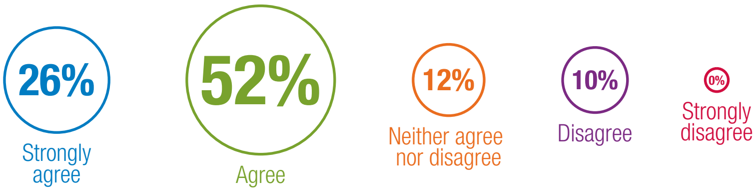
Some three quarters of those surveyed regard its investment prospects as "good" or "very good" but, if anything, the interviewees are far more effusive in their support of logistics and the rewards it can offer. "The guy who is not earning money in this sector now must be a little bit stupid," says one interviewee.

Some have just made or are about to make a strategic move into logistics; as one French fund manager enthuses: "We love logistics and that's where we see lots of opportunities."

Another French investor puts it like this: "Prices of logistics assets have become crazy with some initial yields as low as 6 percent."

Too crazy? There are certainly dissenters, voicing some concern over the yield compression in logistics. But the overwhelming majority of *Emerging Trends Europe*'s constituents are backing the sector, at least for one more year. "It is expensive but the yield compression is still coming through and you're also going to see rental growth," says one fan.

Development is an attractive way to acquire prime assets



Development returns

"With prices so high you have to look at where you can develop to find adequate returns. The markets for income-producing real estate are pretty fully priced so you want to be creating assets that you can sell into that market."

That's a pan-European institutional investor speaking, but it sums up the approach to development of a good number of those canvassed by *Emerging Trends Europe*: not throwing caution to the wind but a measured and pragmatic means of securing returns.

"I wouldn't say that we're becoming more risky because we've been doing development for years – we've done €5 billion over the last few years. It isn't a huge part of our assets under management but it is something we feel comfortable doing," says a French institutional investor.

Global investors are taking on development projects, sometimes building or redeveloping an entire new urban district. Not only does this provide them with shiny new core assets, but also gives them control over the process.

What is more, development is not always seen as a means of investing in core property. "We will develop as value-add, really to open the market and cover it more broadly for our investors. You need to find higher returns somehow," says a cross-border fund manager.

"Yes, we are taking on more risk," says a German investment manager. "We are going into development and value-added stuff, properties with leasing risk and cap-ex requirements. That is quite normal to stay in the market. We do it very wisely and not too aggressively, but that will continue because the availability of prime assets is very challenging for all of us."

There are even development plans for London, despite some late-in-the-cycle jitters about the state of the office market. Says one CEO: "We are in very good shape. People would maybe say that we are cautious but we are prepared to be speculative. You need to know your markets. We know how to build and are a very hands-on business."

Creation of 'place' is becoming the most important factor for real estate performance

City connections

"New market opportunities are now cities rather than whole countries." This approach to investment is gaining currency in Europe.

Opportunities flow from urbanisation, according to a Dutch institutional investor: "We don't invest in countries anymore, we invest in urban areas."

Yet success here is not simply about passive acceptance of the move to urban life, but identifying those cities that are progressive in their approach to infrastructure. The pressure comes from delivering all the necessary development to service this increasing urbanisation.

"If cities are not planning or delivering infrastructure then they are declining," says one planner. "Availability of more infrastructure – successful cities are all about trade and exchange – and connectivity to every asset class are key to attracting the best talent and securing investments."

In this context, it is no surprise that Berlin tops the city rankings this year, for both investment and development prospects, even though *Emerging Trends Europe*'s constituency has a more mixed outlook for Germany as a whole.

"Berlin has come on our horizon much more strongly just because of the wealth of opportunity there," says a pan-European fund manager. Many agree.

As one London-based property player, says: "My one long-term bet is Berlin. It has no manufacturing, but it is the seat of government and it is gradually becoming an important city for Germany, and it has the land to grow. It has also got an innovative, young population and I think tech in Berlin will be a sector that is going to expand."

> "We don't invest in countries anymore, we invest in urban areas."

Residential and student accommodation are now mainstream investment sectors

Housing people

Residential investment continues to grow in importance to Europe's real estate industry, as just a glance at the league table for sector investment prospects will testify – housing in its various forms occupies four of the top eight places.

This has been a feature of *Emerging Trends Europe* for several years, but what is clear is that investors' interest in housing is changing focus. Not so long ago, the sector represented diversification from commercial property: no more, no less. Now it is invariably viewed in the context of the key megatrends affecting society, especially the growth of cities.

"Urbanisation and demographics will feed into what you need for big cities – a good balanced economy, which is more employment, more housing and affordable housing," says one interviewee.

"There is a huge shortage of new residential units and the pricing is out of the reach of a lot of people. That will push a lot of people to rent for longer," says an Irish investor. "I wouldn't say it's shooting fish in a barrel but the balance between supply and demand means this is a very, very fertile ground. There is a lot of institutional investor interest in buying the end product. For the next eight to 10 years that's going to be a huge opportunity."

There are similar, dire housing supply problems across Europe.

This is not to diminish the possibility of market shocks along the way. The high-end residential sector in London slowed in 2015 following onerous changes to stamp duty, and some fall-out is expected in 2016.

But long term, residential real estate looks worthwhile on many levels. One investment banker puts it bluntly: "Urbanisation will increase demand for housing in urban areas."

> "There is a huge shortage of new residential units and the pricing is out of the reach of a lot of people."

Attractive alternatives

When prime property looks expensive, alternative asset classes start to look attractive and European real estate is at the tipping point.

Says one Dutch institution: "The pricing of core real estate is too high, so the way around it is to be more creative and more active in the value-add and opportunistic space and also niche sectors like elderly care, student housing and self-storage."

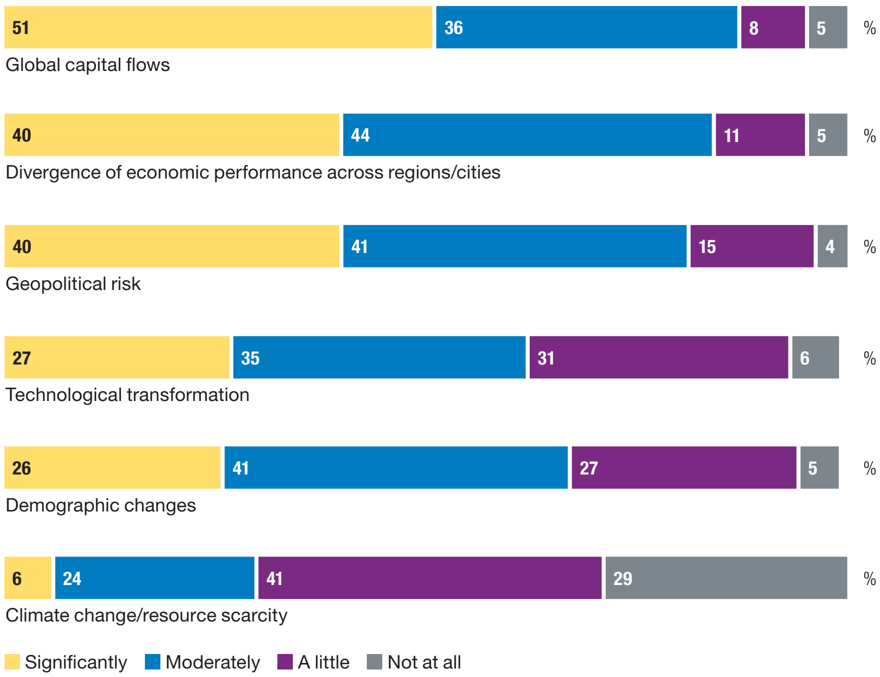
Once more, the alternative sectors take top spots in *Emerging Trends Europe*'s rankings of investment prospects for 2016. Healthcare, hotels, student accommodation and data centres are all expected to outperform core commercial real estate.

This is not merely a chase for yield, but also a growing acknowledgement that many of these sectors benefit from demographic changes and urbanisation, although not everyone is convinced. The sceptics steer clear, citing reputational or operational risks, or that these sectors are currently too small for the amount of capital they need to deploy.

Even so, as many as 41 percent of survey respondents say they are thinking of investing in alternative sectors, a sharp increase on the 2015 figure of 28 percent.

When markets get tough, capital tends to refocus on core property. "But at the moment we are still more bullish on alternatives," says one global fund manager, who is actively investing in student accommodation, healthcare and the private rented sector across Europe.

Figure 1-10 **Influence on investment strategy over next 3-5 years**



Source: *Emerging Trends Europe* survey 2016

Migration

As *Emerging Trends Europe* was gathering the views of the real estate industry for this report, the flood of migrants fleeing the conflicts in the Middle East dominated the news agenda, and cropped up as an issue in more than 10 percent of all interviews conducted. “Immigration is a huge topic and something we’re really going to have to get our heads around,” says one sovereign wealth investor.

This influx of people, crossing borders on a scale unprecedented since the second World War, poses enormous issues for European nations – and their cities. How will this populace be distributed, housed and supported? Can Europe’s infrastructure, both physical and social, cope?

Interviewees spoke about both the pros and cons of migration: the economic benefits of population growth versus increased spending required; the need for more housing.

Germany in particular, with its decision to take a greater number of migrants than its European neighbours, was a particular focus.

“In one sense net immigration is good for Germany with young workers coming to the country,” says one investor. “But in a socio-political sense you must question how many of the net immigrants coming in will be able to get jobs. It may be the second or third generation before the benefits are felt and in the meantime there will be costs if it really is going to be a million people a year coming in and the integration of those people will take time. They will be taking up a lot of residential space. That will be the major political and socio-economic theme for Germany in the next ten years.”

“Migration is a massive issue from a real estate point of view,” says another. “It is a big concern because you have a housing crisis; most countries can’t house what they have already. But it is also an opportunity for development, which means that the governments need to relax planning controls very quickly to meet the demand for housing. The risk is if the development goes wrong or you have disparate nationalities put together in the wrong way. But either way, with the trend towards urbanisation, and its impact on housing, it is going to be a massive issue.”

“Migration is a massive issue from a real estate point of view. It's a big concern because most countries can't house what they have already. But it is also an opportunity for development.”

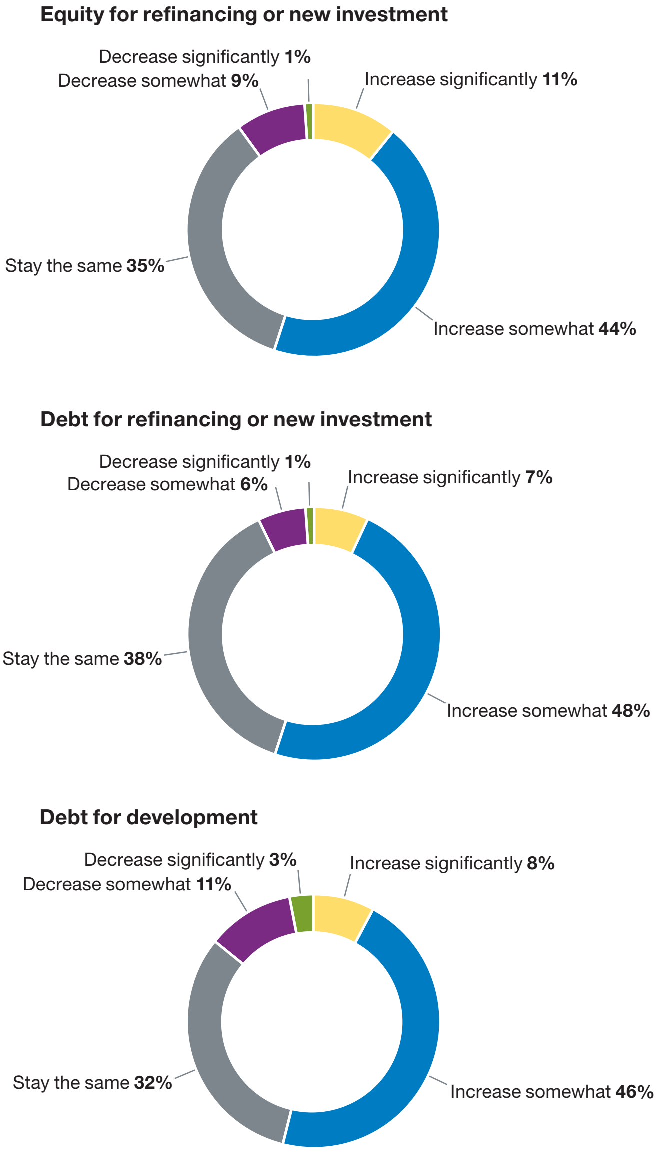
Chapter 2

Real estate capital markets

"If you can somehow achieve steady growth and invest the capital sensibly, that's the Goldilocks scenario. So far we've been able to do that, but it could be a bigger challenge in the next 12 months," says one cross-border investor.

It is a common sentiment among *Emerging Trends Europe*'s survey respondents and interviewees. The outlook for capital markets in Europe in 2016 remains very positive, albeit with a more pronounced note of caution than was exhibited by real estate professionals in 2015.

Figure 2-1 **Availability of equity and debt in 2016**



Source: *Emerging Trends Europe* survey 2016

Liquidity is expected to remain high, and most economies are improving. But competition is fierce. The prices of prime assets are at historic highs and secondary ones are also climbing, making deployment of capital more difficult and introducing an increasing element of risk.

All across Europe, the real estate industry is trying to read the cycle. "It will be another two years before something goes wrong," predicts an investment manager – who is planning to sell half his London portfolio. "Buyers are behaving like in 2006," says a global investor. "Perhaps soon it is the time to hibernate," muses another.

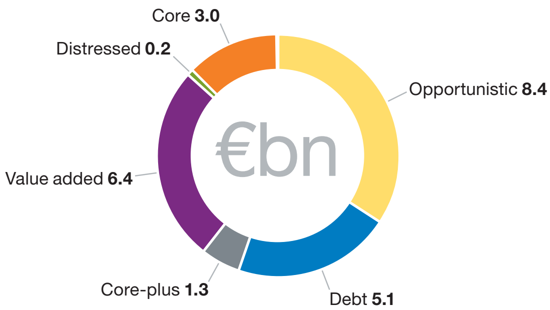
Super-low bond yields, with no sign of a rise on the horizon, are giving investors comfort, but there is nervousness that the rise in prices continues to outpace the rise in rents.

This is particularly true of the UK, where there is a growing sentiment that values, particularly in London, have peaked. "We would say that you are taking on extraordinary risk to buy at this moment in City and Mayfair offices," says an investor. Prime London residential is also identified as a sub-sector where there may be distressed opportunities soon because of overly optimistic valuation targets from developers, a drop in Asian capital and a hike in stamp duty for higher-priced property.

But in most of continental Europe, prices are expected to continue upwards, driven by increased liquidity and rising rents. "In prime, we are close to the top in terms of yield." says a Portuguese interviewee.

Global capital is disrupting local property markets

Figure 2-2 **Capital raised by private equity real estate funds for European real estate, Q4 2014–Q3 2015**



Source: Preqin 2015

Capital tide

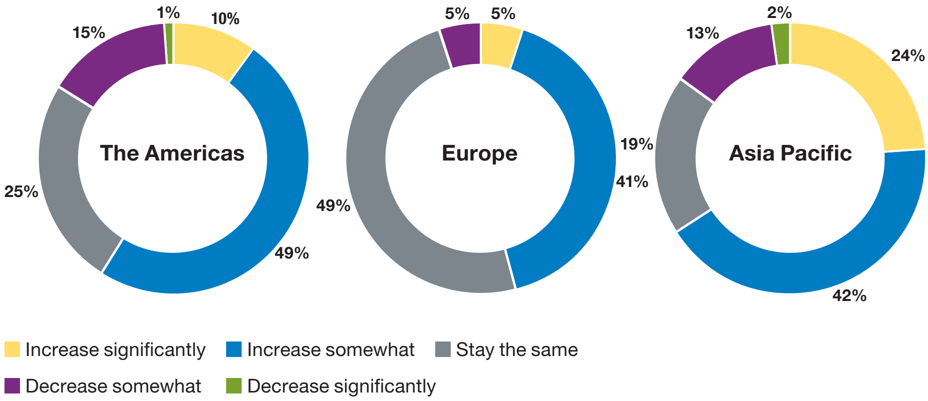
Europe's real estate industry believes equity will continue to flood into its market in 2016. However, expectations are notably lower than they were for 2015; 55 percent say the amount of equity available for refinancing or new investment will increase or significantly increase, compared with 71 percent last year.

"If you look at the alternatives for investors, there is not really that much," says one institutional fund manager. "We expect that a lot of money coming into the real estate sector will continue."

Capital appears to be available for investment at all points of the risk curve. Private equity funds raised €24.5 billion for European real estate in the year ended Q3 2015, as much as in any full year since 2007, and another 416 are on the road looking to raise $152 billion globally, a record figure. At the other end of the risk scale, German property funds took in €2.4 billion of new money over the first three quarters of 2015, six times the 2014 figure.

> "If you look at the alternatives to real estate for investors, there is not really that much."

Figure 2-3 **Cross-border capital into European real estate in 2016**



Source: *Emerging Trends Europe* survey 2016

Eastern downdraft?

Cross-border capital flows are also expected to increase, but at a more measured rate. Some 59 percent of respondents expect an increase or significant increase from the Americas, against 65 percent last year, and the same is true of Asia, although 66 percent of respondents still feel there would be an increase in Asian capital.

But *Emerging Trends Europe*'s interviewees express uncertainty about the likely flow of capital from the Middle and Far East. Sharp falls in commodities prices, volatile stock markets and political instability may take their toll.

"In a place like London there's a lot of capital chasing a bunch of City office buildings, and given what's happened in the summer in China a lot of that is pulling back," says one cross-border investor. "The Chinese life companies were pushing pricing up and in most cases they were the marginal bidder, but that is not the case anymore."

"There is a much more volatile scenario where some of the Asian players – from Malaysia, for example – are expected to retain their capital in their domestic markets," says one global fund manager, referring to the decision in January 2015 – since reversed – by the Malaysian government ordering sovereign wealth and superannuation funds to suspend overseas investment and repatriate capital to shore up a faltering domestic economy.

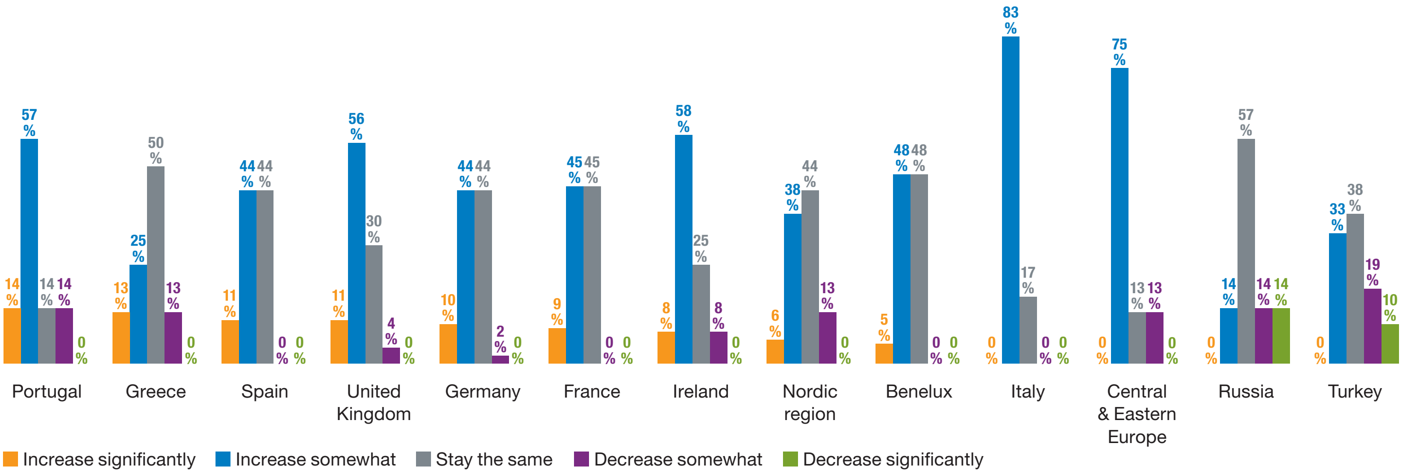
It is yet unclear what impact the decline in oil prices will have on oil-producing countries' sovereign wealth funds (SWFs) and their asset allocations. They have been high-profile buyers of "trophy" real estate across the globe, but will lower inflows mean they will need to draw back?

One investor says: "It really depends on who you are. Sovereign wealth funds still have an enormous capital base and still have a lot of money to spend. If this is a long-term trend towards lower oil prices then it would have an enormous impact over time, but in the immediate term I don't think it will have a huge impact on things."

But for some oil-funded SWFs, the drop in oil price has a positive side, easing the pressure to invest. "And if you look at it from the point of view of the real estate portfolio it is actually positive. We need to get a real estate allocation to 5 percent of total assets under management. So less cash inflows makes that easier to achieve in this difficult market," says one.

And while some capital sources are waning or erratic, others are emerging: "On the horizon is the ability of Japanese pension funds to start looking seriously at investing abroad, and that's a huge amount of money," points out one broker.

Figure 2-4 **Availability of debt across Europe in 2016**



Source: *Emerging Trends Europe* survey 2016

Debt distribution

Real estate debt is now plentiful in most European markets. About half of those surveyed expect it to increase in 2016 and the flow of development finance is also growing. However, lenders are not yet taking excessive risks, and no-one is straying too far out of their comfort zone in search of higher returns.

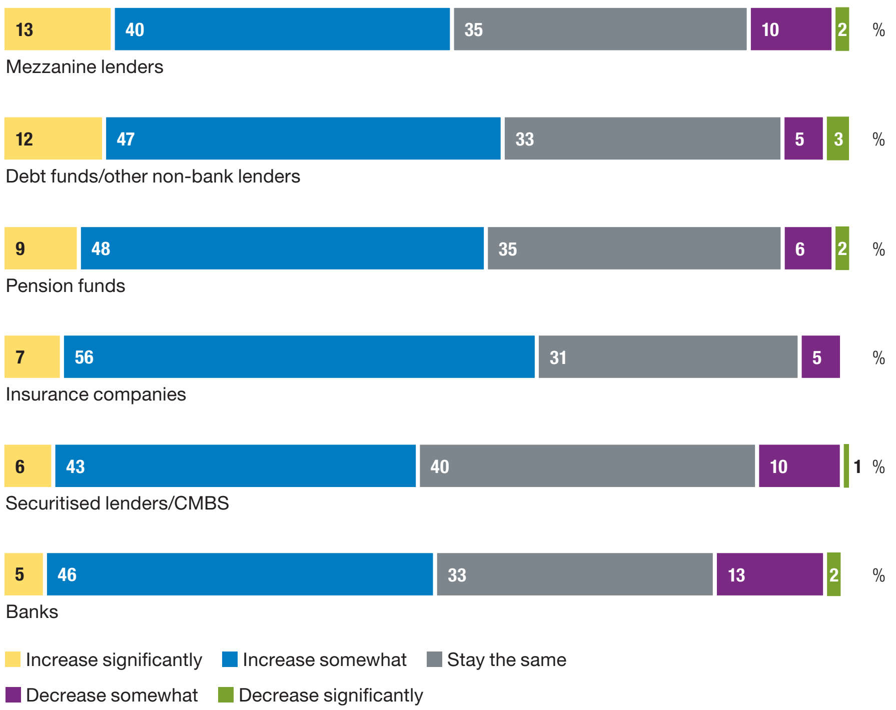
And with the largest proportion of respondents, 47 percent, predicting short-term interest rates will stay the same, and just 3 percent foreseeing a significant rise in rates even in the long term, the benign financial conditions for real estate are set to continue. There are exceptions, notably Russia and Turkey, where political and economic uncertainties are stifling expectations.

There is yet no sign of lenders loosening their criteria and introducing risk back into the system. “At no point in my career did I lose money lending at conservative loan-to-value ratios,” says a banker.

“I am reasonably positive, but there's some nervousness around the market,” says another financier. “The CMBS market and the macro-economy seem to have come off a little on the back of what's happened in China and the prospect of rates rising, and pricing has increased.”

Funding sources are diversifying, and though fewer respondents feel that commercial mortgage-backed securities (CMBS) and lending from insurance companies will increase in 2016, over half expect that debt funds and other non-bank lenders will be more open-handed.

Figure 2-5 **Sources of debt in 2016**



Source: *Emerging Trends Europe* survey 2016

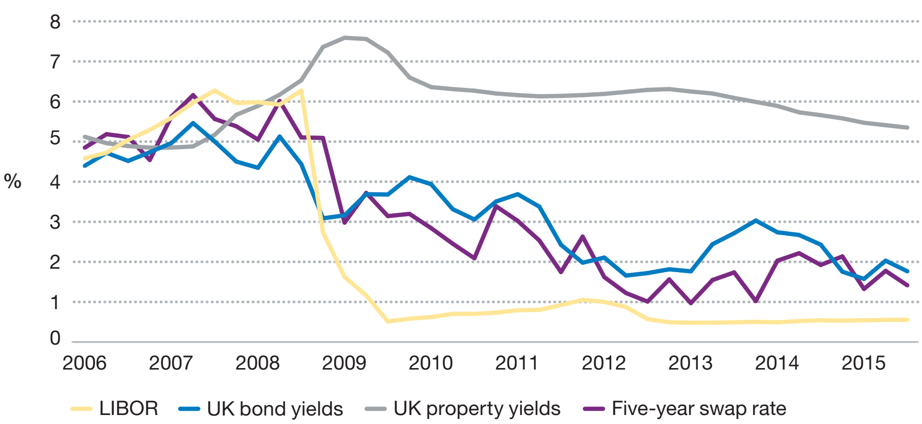
And while development finance has increased, on the whole, lenders are not becoming too aggressive or moving up the risk curve, preferring to compete with each other by reducing margins rather than increasing loan-to-values. This means there is no prospect yet of another downturn in prices being caused by excessive leverage.

"This time, if you have a severe correction it will be driven from the equity side of the equation," says one sovereign investor. "You might have pension funds or other kinds of institutional fund or REITs that have a call on their capital, people saying 'give me my money', and that body will not have the ability to easily provide that equity, so they will have to sell real estate. That cascades down through the system and has an effect on pricing."

47%

predict short-term interest rates will stay the same.

Figure 2-6 **UK property yields and interest rates, 2006–2015**



Source: CBRE, Datastream, ICE

Where to go?

It is becoming increasingly redundant to talk about targeting a specific country; recognition of the effects of urbanisation is leading investors to think more and more about cities or even specific districts. As one investor puts it: "There are probably still opportunities, but not in a specific geographic region but at the asset level."

This is even more the case given that in 2016 there is no obvious macro play, particularly for private equity or hedge fund buyers, to exploit. Whereas the UK, then Ireland and Spain have proved compelling for investors, now "distress is relative".

Italy is clearly a target and has a fan base, but it remains an opaque and difficult place in which to buy. The banking market is still clogged, in terms of both divesting non-performing loans and providing new lending. The Netherlands will provide plenty of opportunities to buy at big discounts to previous sales prices, but the office market continues to be fundamentally oversupplied.

Some mainstream investors believe that Portugal "demands a closer look" and that Greece is "so depressed that it is a good time to take a look". Even Russia, a no-go area for most, has its supporters. "Wherever there is stress there can be opportunities. We are doing quite well in Russia," claims one investment manager.

"Go into areas where the competition is less and you will find opportunities. We are building in the provinces."

And investors remain wary about the challenges that beset Central and Eastern Europe, pointing out that "the issue you have in these markets is one of scale". One pan-European fund manager observes: "CEE markets such as Hungary and Czech Republic offer distressed opportunities if investors are willing to take political risk. But with Bulgaria and Romania, it's too early; there's no real point going there."

But it is the biggest market of the lot, the UK, and particularly London, that holds the most intrigue for 2016. There is a clear belief that the UK is further through its investment cycle than continental Europe. Yields are not expected to compress much further, and the better-performing UK economy would indicate that interest rates will rise here before they do in the Eurozone, especially now that the US Federal Reserve has recently raised interest rates by 0.25 percent for the first time since 2006.

Its slip to Number 15 in this year's *Emerging Trends Europe* city rankings for London's investment prospects reflects the common view that "central London pricing has become toppish and therefore less attractive going forward".

Yet the UK's regions still hold some promise. Birmingham's position at Number 6 in the rankings shows investors are positive about prospects there. "Go into areas where the competition is less and you will find opportunities. We are building in the provinces," says one global investor and developer.

The same degree of regional drift is not so apparent in the Eurozone. "We do find opportunities in secondary cities but we do not give in on location," says a Dutch investment manager. "We still find good value in non-prime but core Eurozone," says a pan-European fund manager. "We've just bought a shopping centre in Belgium, for example, but it's stock specific. I don't have an allocation to Belgium; I have an allocation to good buildings."

Alternative real estate sectors offer good opportunities

"There is a lot more of a discussion about the downside of the market, less discussion about the upside than there was a year ago."

Staying in the zone

While equity and debt for development are more readily available, and investors are increasingly willing to consider alternative locations and sectors, on the whole, there is no evidence of people veering too far from their comfort zone to chase higher returns. "Everyone has gone up the risk curve already," says one fund manager.

The mission creep appears to be minor. Core investors might look at core plus, or taking some leasing risk, but "what you're not seeing are core investors going into opportunistic deals, nobody is taking that approach".

If anything, investors are accepting lower returns in exchange for reducing the possibility of being caught out buying the wrong asset. "Investors are asking when will the end of the party come, and that is something that they are asking a lot more than 12 months ago," says an institutional fund manager.

"There is a lot more of a discussion about the downside to the market, less discussion about the upside than there was a year ago. People are not interested in the last 10 or 20 basis points of return, more how they can reduce the risk on their investment."

However, investors and lenders are now undoubtedly much more comfortable with development risk. Some 80 percent of those surveyed agree that it is an attractive route to acquiring prime assets and, across Europe, a significant section of the industry is starting – cautiously – to build.

"We've gone into development in some markets where we think it's justified," says one institution. "It gives us an opportunity to create increased returns, although it's not a huge part of the overall portfolio so that decreases the risk."

A sovereign wealth fund adds: "Because we have no requirement for income and no obligation to invest, we are very well-placed to look at development. The markets for income-producing real estate are pretty fully priced so you want to be creating assets that you can sell into that market."

The *Emerging Trends Europe* interviews indicate a transition in the investment approach from the larger institutions, driven by the trend towards urbanisation. There is a shift from geographical diversification to concentration and control as investors place their bets on cities, then go big. This may involve more development or mixed-use exposure but the risks are minimised by adopting a strategy that exploits what respondents identify as an increasing polarisation between prime and secondary assets and locations.

Sectoral shifts

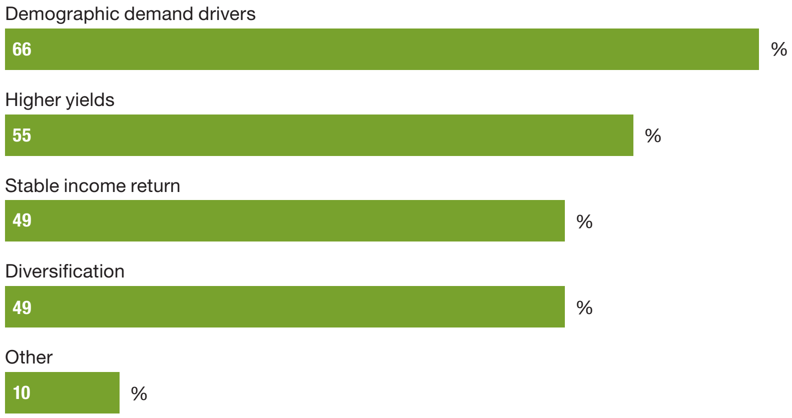
This year, the European real estate industry is signalling an encouraging willingness to embrace alternative sectors. Of those surveyed, 41 percent say they are thinking of investing in alternative sectors, a sharp increase on the 2015 figure of 28 percent.

This shift is being driven partly by the realisation that demographic changes and other megatrends like urbanisation are working in favour of these sectors, particularly residential in most of its forms. Investors like the fact that alternative sectors capture the way people and societies are changing.

Demographic demand drivers feature most prominently in their thinking; 66 percent of those who are considering going into alternatives cite this attraction, followed by higher yields and stable income.

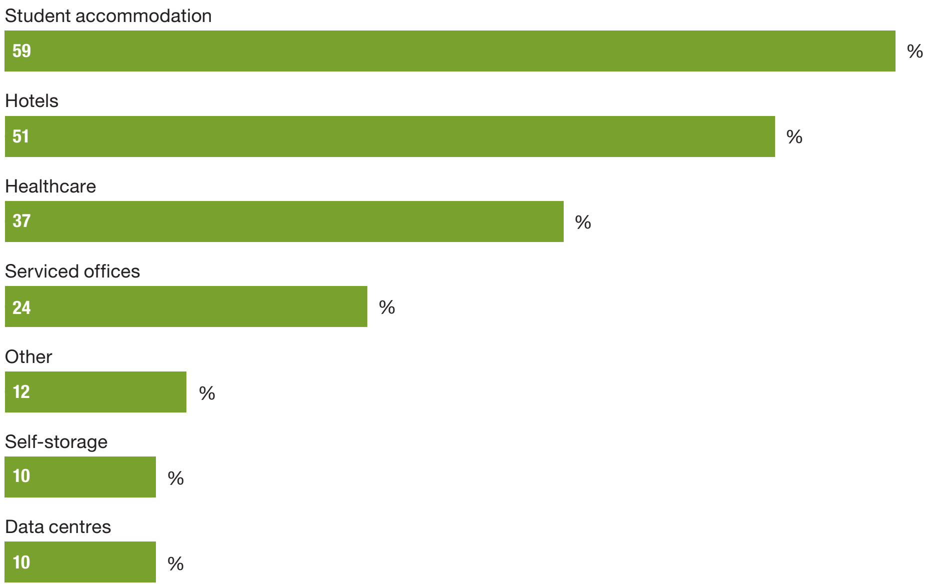
Student accommodation and hotels are the most popular by some distance, both with those already active and those who are thinking of moving beyond the traditional sectors. Healthcare is also making a healthy showing, but self-storage and data centres still have some way to go before they are considered attractive investment options by those not yet active in these arenas.

Figure 2-7 **Reasons for considering alternatives**



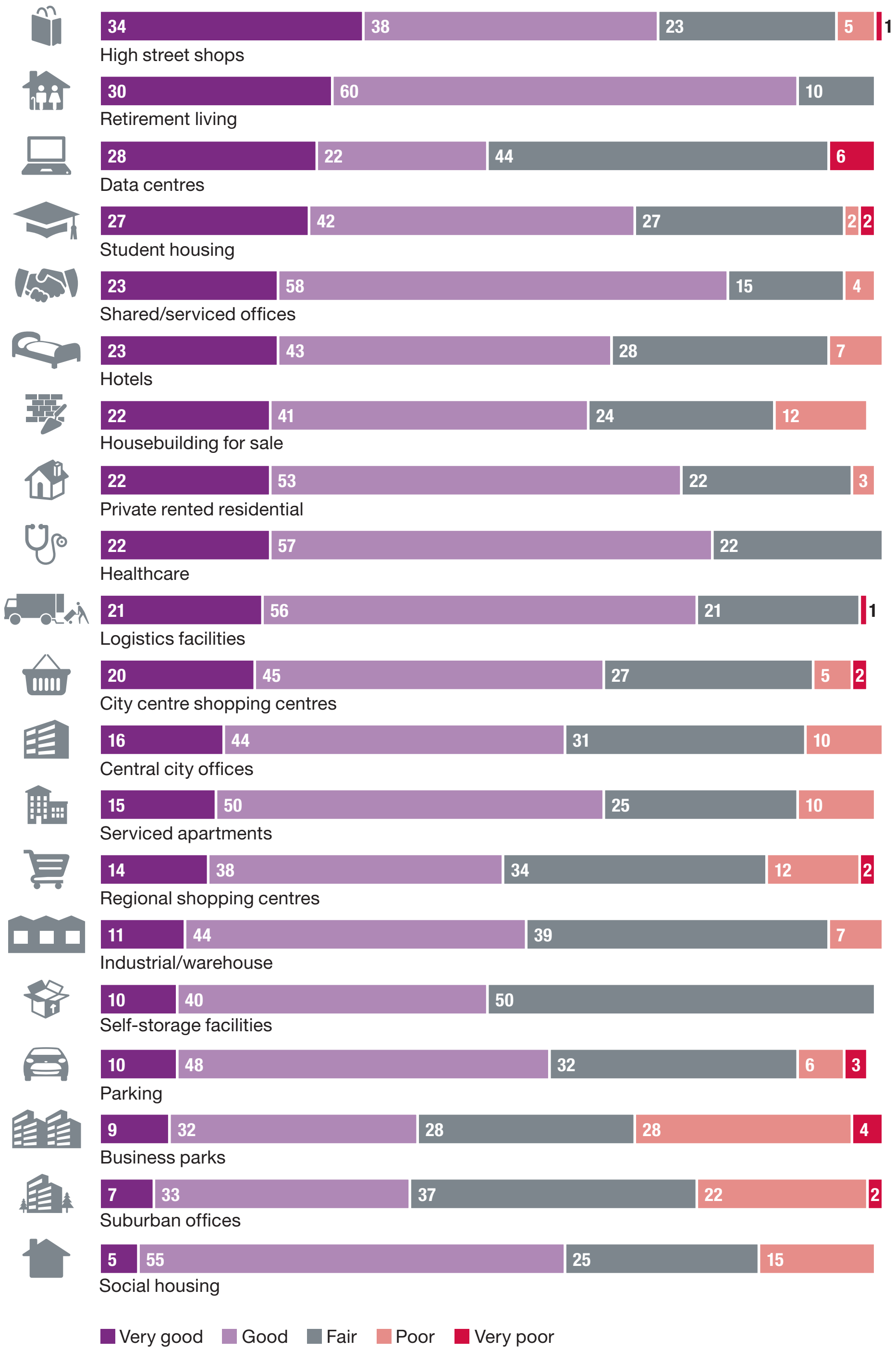
Source: *Emerging Trends Europe* survey 2016

Figure 2-8 **Sectors being considered**



Source: *Emerging Trends Europe* survey 2016

Figure 2-9 **Sector investment prospects, 2016**



Source: *Emerging Trends Europe* survey 2016

For many respondents and interviewees this move into new sectoral territory links to their search for income and returns. For as in previous years, the alternative sectors take top spots in *Emerging Trends Europe*'s rankings of investment prospects for 2016.

However, it is high street retail that takes the gold, further highlighting the industry's view that urbanisation is a megatrend to follow. Low oil prices and improving economies are also putting more money in consumers' pockets.

But the next eight places are all taken up by what would be considered alternative real estate. Shared offices receive a high rating on the back of the growth of co-working spaces favoured by creative occupiers, and the ageing population sees retirement living becoming the sector with the second highest prospect for returns. Healthcare also edges logistics, a mainstream sector that has shown intense yield compression in recent years.

The impact of urbanisation is also highlighted by those sectors left behind and judged to have the worst prospects – with suburban offices and business parks taking up two of the bottom three places.

Chapter 3

Markets to watch

"Good prospects, a lot of capital" – this is what most of Europe's real estate professionals are saying about their markets for 2016.

"Global capital movements are increasingly targeting 'exotic' destinations such as Lisbon, where the market is picking up again."

Strengthening recovery is the story in most of Europe's major cities; expanding economies, more liquid credit, low interest rates, and growing demand from occupiers underpins an optimistic view of real estate. None of the 28 cities surveyed in *Emerging Trends Europe* is judged to be a poor investment prospect in 2016.

The strength of Germany's economy and its main real estate markets shines through again in this year's *Emerging Trends Europe*. The capital, Berlin, tops the rankings for both investment and development, while Hamburg takes the silver and Munich also features in the top 10.

Sentiment also remains positive towards Dublin, putting the Irish capital at Number 3 for investment and Number 6 for development in 2016. Distressed bargains are no longer the attraction here; it is rental growth restarting in a market where little new stock has been created. "We are seeing real demand from overseas companies setting up in the city centre with younger staff who want to live in the city centre. That creates opportunities," says an institutional investor.

The story has also moved on in Southern Europe. Spain is the furthest advanced in its recovery and Madrid remains high up the investment rankings at Number 4, but some feel "overheating is clearly a threat". Next door in Portugal, Lisbon is also basking in popularity at Number 7, though the small size of its market deters some.

Italy, however, is the one to watch. Milan, with its more dynamic and prosperous economic base, is the favoured city at Number 8. Rome is still judged to be a poor prospect for investment, but has an improved outlook for development.

This year, there is also renewed interest in Nordic countries. Stockholm's popularity remains high as a development destination at Number 4, but it is now also held in higher esteem for investment. Copenhagen has emerged from recession positively too and is placed Number 5. Helsinki, however, fares less well given Finland's weak economy and close trading links with a sanctions-strapped Russia.

The picture is more mixed in central Europe. While sentiment towards Prague and Warsaw has slipped, Budapest's potential as an investment destination has leapt to Number 13 in popularity, possibly owing to its improved political stability, although this is not matched by views of the city as a place in which to do development.

So far, so predictable. But what is notable is that both of Europe's preeminent real estate markets, London and Paris, are languishing outside the top 10 favoured cities for investment in 2016.

We see strong opportunities in Europe's gateway cities

But their paths to these rankings are quite different. London's sparkle has faded, and it has fallen five places to Number 15 for investment – "too expensive". Meanwhile, Paris remains lowly ranked at Number 22; paradoxically it is considered both too expensive and with poor fundamentals: "continued pressure on rents, economy poor, demand weak".

London and Paris's rankings also reflect the strengthening recovery of Europe's other real estate markets. Post-crisis, capital has concentrated on the continent's biggest cities, the ones where growth starts first. As it starts to ripple out, attention shifts to lesser centres – smaller capital cities or regional ones like Birmingham in the UK, now Number 6.

However, none of this, it must be said, appears to deter investors from pouring money into London or Paris. These two gateways have seen €57 billion of deals in the year to Q3 2015. For everyone who says they do not think the cities are offering good value, there is another who cites the irresistible global magnetism of a deep, mature, liquid and politically stable playing field.

Political uncertainty is an issue that is weighing heavily on investors' minds. They cite it as a reason for avoiding Russia, Turkey, Greece – and Scotland. Istanbul's prospects, currently mid-table at Number 14, might potentially be brighter were it not for Turkey's electoral swings and proximity to the conflicts in the Middle East. The same applies to Edinburgh, where the continuing possibility of Scotland's exit from the United Kingdom has it at Number 18.

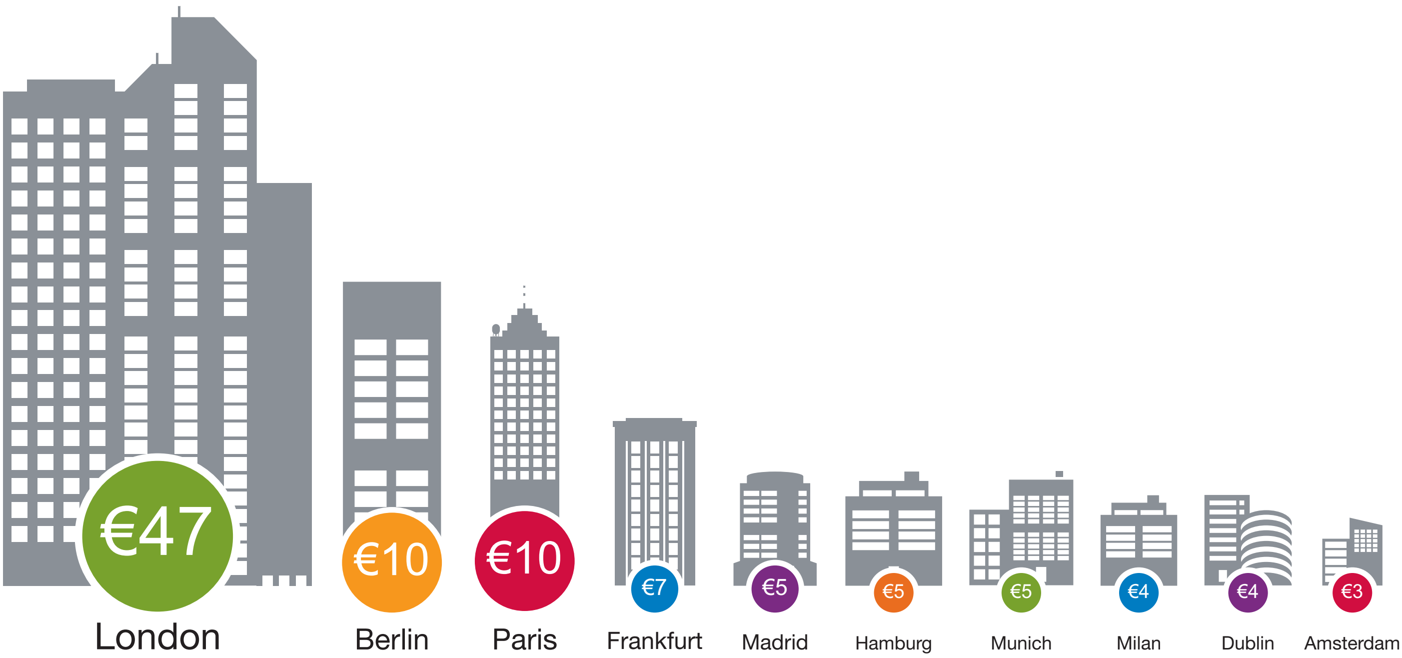
But it is Athens and Moscow that are no-go for most in 2016. Athens's prospects have tumbled dramatically since last year, when respondents took a surprisingly optimistic view of its prospects. Now, two elections, a Grexit narrowly fended off, and an agreed austerity programme later, the Greek capital is Number 27 – possibly a more realistic view of its prospects.

The horizon for a real estate recovery is regarded by most as too far off, even for high-risk deals. "Some people are coming into the market, but so far the majority are window shopping."

And Moscow, unsurprisingly, lies bottom of the European prospects league for a second consecutive year. Its real estate market is judged by locals to have bottomed out, but most outsiders are not going to risk going in. "With Russia, until there is clarity with what's going to happen with the economic sanctions I think it's a country that people will steer away from," says a pan-European investor.

"Some people are coming into the market but so far the majority are window shopping."

Figure 3-1 **Europe's 10 most active markets, Q4 2014–Q3 2015 (billions)**



Source: Real Capital Analytics

Figure 3-2 **City investment prospects**

Table 3-1 **Investment and development prospects, 2016**

		Investment	Development
1	Berlin	4.13	4.05
2	Hamburg	3.92	3.78
3	Dublin	3.86	3.70
4	Madrid	3.84	3.39
5	Copenhagen	3.76	3.71
6	Birmingham	3.75	3.53
7	Lisbon	3.72	3.06
8	Milan	3.69	3.22
9	Amsterdam	3.66	3.13
10	Munich	3.65	3.80
11	Stockholm	3.64	3.75
12	Barcelona	3.63	3.08
13	Budapest	3.59	2.76
14	Istanbul	3.58	3.63
15	London	3.55	3.39
16	Helsinki	3.55	2.96
17	Warsaw	3.53	3.06
18	Edinburgh	3.53	3.47
19	Prague	3.48	3.07
20	Frankfurt	3.46	3.41
21	Brussels	3.44	3.03
22	Paris	3.44	3.16
23	Vienna	3.44	3.45
24	Zurich	3.38	2.92
25	Rome	3.29	3.08
26	Lyon	3.24	3.10
27	Athens	2.76	1.76
28	Moscow	2.75	2.44

Good = above 3.5 Fair = 2.5-3.5 Poor = 1 to 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.

Source: *Emerging Trends Europe* survey 2016

Table 3-2 **Change expected in amount invested, rents and capital values in 2016**

		Amount invested	Rents	Capital values
1	Berlin	4.05	3.96	3.93
2	Milan	3.94	3.27	3.70
3	Madrid	3.86	3.63	3.72
4	Birmingham	3.74	3.75	3.80
5	Hamburg	3.67	3.65	3.71
6	Amsterdam	3.66	3.45	3.70
7	Athens	3.65	2.60	2.79
8	Budapest	3.63	3.31	3.50
9	Rome	3.59	3.09	3.55
10	Lisbon	3.59	3.12	3.41
11	Copenhagen	3.53	3.05	3.67
12	Munich	3.52	3.78	3.79
13	Barcelona	3.50	3.51	3.57
14	Paris	3.47	3.25	3.43
15	Helsinki	3.45	2.75	3.48
16	Frankfurt	3.45	3.34	3.53
17	Dublin	3.42	4.11	3.85
18	Prague	3.39	2.93	3.22
19	Brussels	3.38	3.15	3.24
20	London	3.38	3.67	3.61
21	Vienna	3.37	3.37	3.45
22	Stockholm	3.28	3.58	3.57
23	Edinburgh	3.26	3.47	3.58
24	Warsaw	3.24	2.53	3.03
25	Istanbul	3.23	3.40	3.21
26	Lyon	3.21	3.11	3.32
27	Zurich	3.08	2.80	3.20
28	Moscow	2.46	2.53	2.36

Increase Stay the same Decrease

Note: Respondents scored the expected change for 2016 compared to 2015 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 expectations regarding the amount of real estate investment that city will receive in 2016.

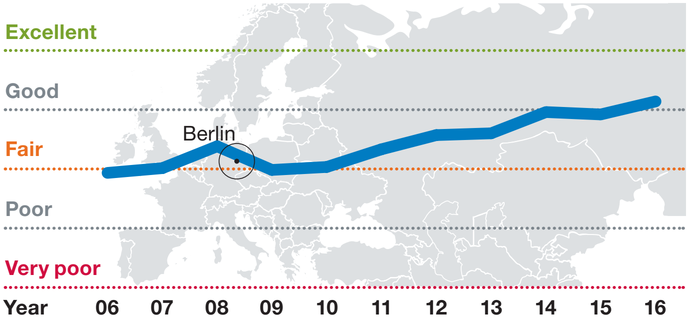
Source: *Emerging Trends Europe* survey 2016

The cities

Every year, Emerging Trends Europe ranks the real estate markets in major European cities according to their investment prospects, as shown in Table 3-2. This section shows how their investment prospects have changed over time; the numbers in parentheses show the city's ranking for investment in 2016 and 2015. The population, employment and disposable income forecasts for the metropolitan areas in 2016 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 2006-2014 are also included.

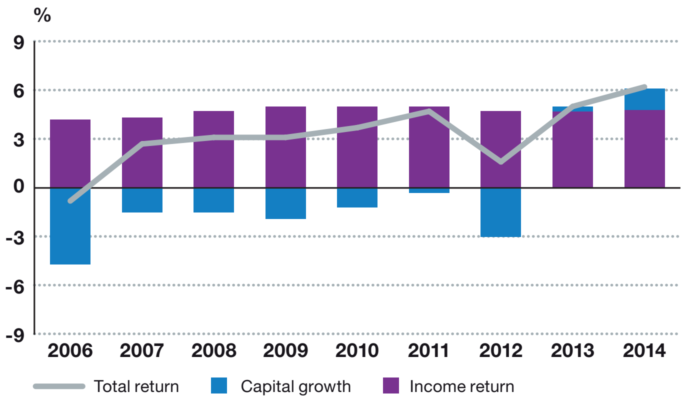
Berlin (2016: 1) (2015: 1)

Investment prospects, 2006-2016



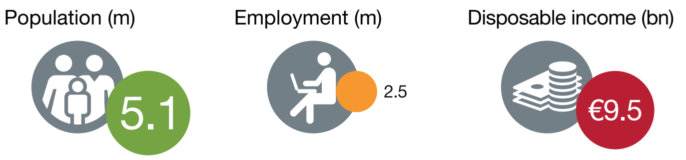
Source: *Emerging Trends Europe* survey 2016

All-property return, 2006-2014



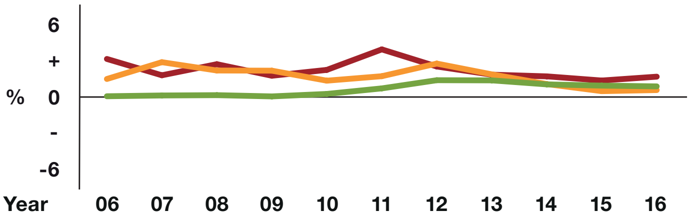
Source: MSCI

Total population, employment and disposable income, 2016



Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

"London is going to continue taking the lion's share of investment but Berlin is getting a lot of attention. It's a city that is still underdeveloped from a real estate point of view," says an investor.

Germany's capital tops the table for both investment and development prospects in 2016.

"Berlin has come on our horizon much more strongly just because of the wealth of opportunity there," says an international fund manager. "All the creative industries are going there; it has got a multitude of different tenant types; it's dynamic; and it has got new infrastructure coming."

Office take up has never been stronger: "Berlin will have probably all-time historic high levels of leasing."

The technology sector is fueling demand: "There is a move from the traditional main driver of take up, the public sector, to IT and tech, which is driving rents. It has a young international employee base and a lower cost of living, which is driving the city forward."

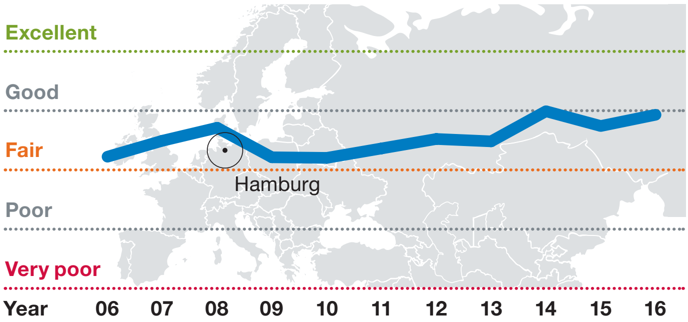
Interviewees also see potential in Berlin's housing sector. "It has got positive migration and very cheap housing, so there is room to raise rents. It is developing as a cultural city and it has evolved a lot in the last 10 years."

In addition, the city's status as one of the hippest locations in Europe has boosted visitor numbers and revitalised the main retail area of City West. Yields for shops there have hardened to less than 4 percent.

Hamburg (2016: 2)

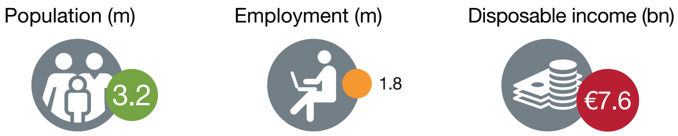
(2015: 4)

Investment prospects, 2006-2016



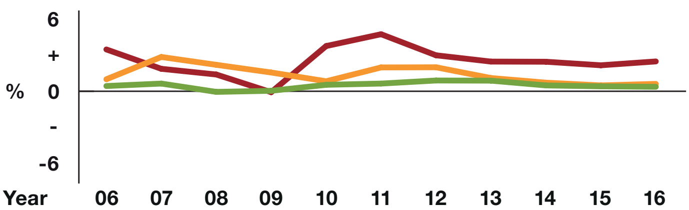
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



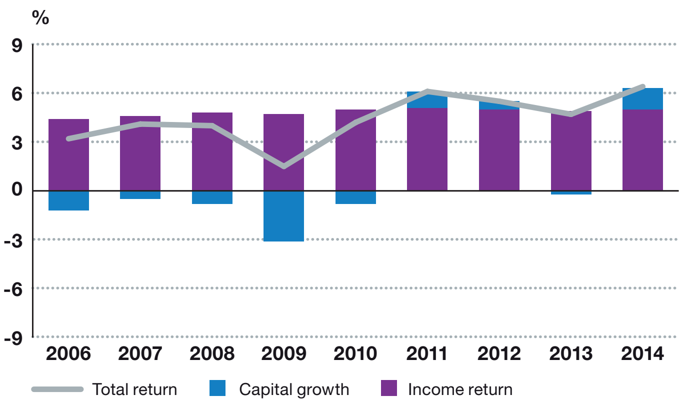
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Hamburg completes a German one-two this year by taking the second spot from Dublin. "Hamburg is doing fabulously. It is a very dynamic city, responding to the needs of occupiers for the future."

More than €5 billion has been invested in Germany's second-biggest city over the year to Q3 2015, making it the sixth most active market in Europe. Around 60 percent of that capital originated with foreign buyers for whom Hamburg provides a safe haven outside the expensive London and Paris markets.

The port city is lauded for the diversity of its occupier base, with demand for offices generated by the media, business services and international trade sectors, including many thriving small and medium-sized enterprises.

"There will be something close to 500,000 square metres leased in Hamburg's office market in 2015, which shows it is a strong market," says a German fund manager.

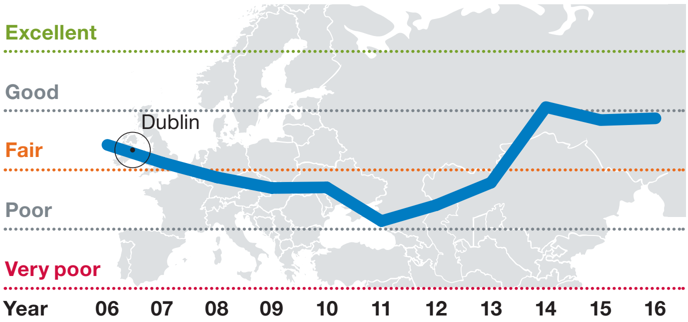
Office vacancy stands at a historic low of 6.4 percent; prime yields have come in to 4.3 percent. Hamburg is placed at Number 3 for development prospects and construction is expected to ramp up in 2016, delivering 127,000 square metres of new offices to ease the currently constrained supply.

A local says: "Hamburg probably still holds a bit of potential compared to other markets like Frankfurt, which has always been looked at very intensively by almost everybody. Frankfurt has historically been very dependent on banking and with banks finding it difficult, the harbour media city is another reason why Hamburg is seen as an alternative for the investment market."

This 157-hectare, mixed-use harbourside redevelopment, HafenCity, has attracted around 500 businesses, employing 10,000 people, as well as buyers for 1,500 apartments. "It has been very successful providing modern, urban, mixed use a short distance from the city centre. That is a whole new market that has been developed in the last 10 years," says an investor.

Dublin (2016: 3) (2015: 2)

Investment prospects, 2006-2016

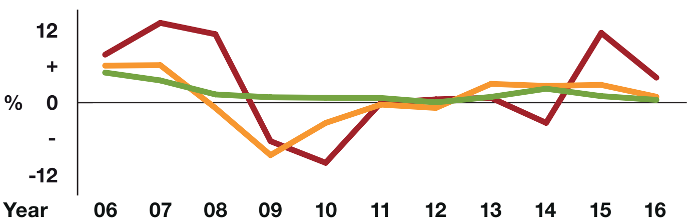


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

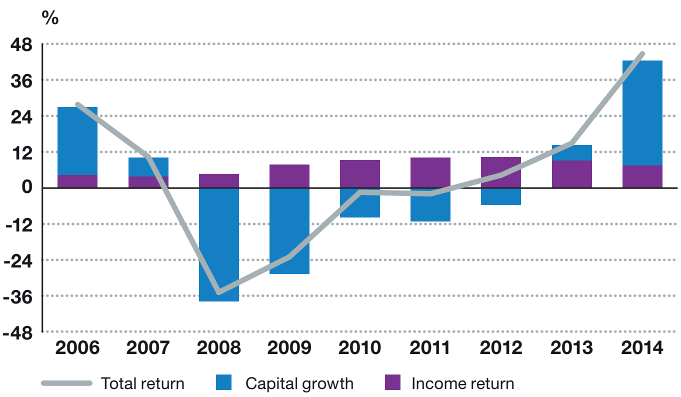
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Dublin is still attracting plenty of capital and maintains its place near the top of the investment rankings at Number 3.

However, the consensus among interviewees is that the best days for opportunistic returns in the Irish capital are over. "I don't anticipate that by the middle of next year Dublin will continue to be the top pick. We will be well through the recovery."

Value growth will soon reach its peak, predicts an investor: "It is a small market and very tight cap rate compression will continue to happen very quickly. We do think there will be rental growth in Dublin offices, but the real pickup in terms of total return will be for those that have already invested or will invest in the very near term."

A local adds: "Further value enhancement will be driven by rental growth. There has been a pretty rapid recovery and people are now beginning to think about the shortage of office space in Dublin. Development will take a while to get moving. The first significant swathes of new supply will be in 2018-19."

Increased appeal to core investors is compensating for the lack of assets suited to bargain hunters. "Some opportunity funds have moved on, but there's a broadening and deepening of interest in the Irish market."

Those seeking higher returns will now have to take on more risk. Opportunistic returns can still be found but they are "in the development space or buying land or buying debt".

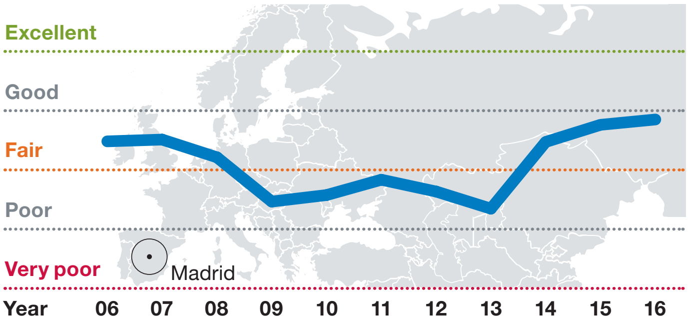
Irish National Asset Management Agency's 2015 sale of its Project Jewel loan portfolio, which includes the country's largest shopping mall in south Dublin, Dundrum Town Centre and the Ilac Centre in Dublin, attracted "six or seven" bids demonstrating the volume of capital seeking to acquire retail assets.

German insurer Allianz's and European retail REIT Hammerson's €1.85 billion offer beat other global players.

"The office recovery is well underway and the retail recovery is just starting. Retailers who have sat on their hands are out looking at the best pitches again."

Madrid (2016: 4) (2015: 3)

Investment prospects, 2006-2016

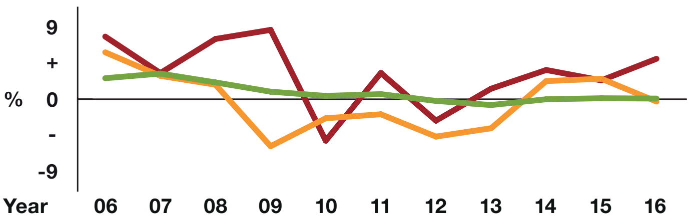


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

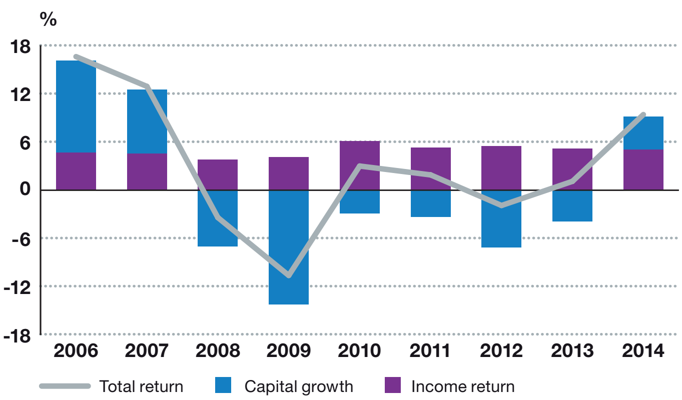
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Spain has been leading the distressed economies of Southern Europe out of recession, and Madrid's Number 4 ranking reflects that. As Spain's economy gathers steam, institutional investors are joining opportunistic ones in the capital.

"More and more people are looking at Madrid even though it is a small city. It has done so well in its recovery that German investors are there, pension funds and insurance companies, even sovereign wealth funds. They are all looking at the city, which in the past they would not have spent any time on."

Indeed, the Spanish capital was Europe's fifth most active real estate market in the four quarters ending Q3 2015, turning over €5 billion. And it is on many people's shopping list for 2016.

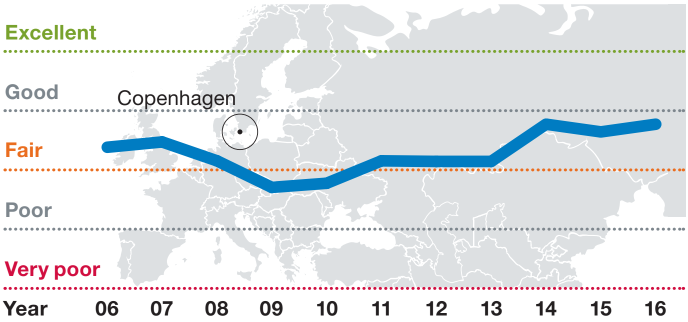
But there are signs rising prices may be spawning some reluctance to invest. "Markets like Madrid or Barcelona do not offer attractive IRRs anymore because they are already too expensive," says a Spanish player. Prime office yields have dipped to sub-4 percent and some believe that yield compression is based on over-optimistic assumptions.

"It appears as though the capital markets are willing to support a 50 percent rental growth in the office market in the coming five years and we're not prepared to make that bet. It may happen in one building, somewhere, but it's not going to happen across the board," says an international investor.

However, tight supply could spur rental growth. "Rents are really starting to go up. If you look at the vacancy rate the headline rate is 10 to 12 percent, but if you zoom in where that vacancy is, it is in obsolete buildings. In class-A buildings the vacancy rate is 2.5 percent."

Copenhagen (2016: 5) (2015: 7)

Investment prospects, 2006-2016

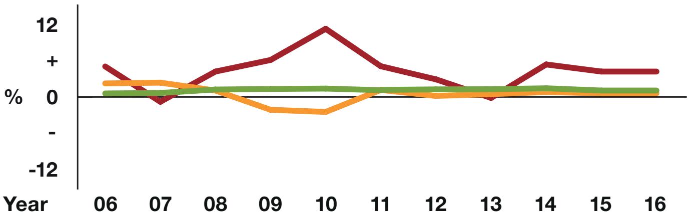


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

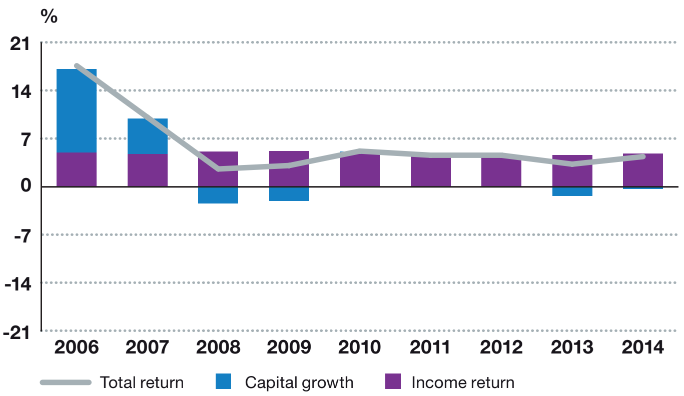
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Previously considered a distressed market, Copenhagen now appears to be "noteworthy". "Denmark has seen the worst and can only go up."

Ranked Number 5 for investment this year, the Danish capital has "good dynamics in terms of younger segments of the population … with growth potential."

The office vacancy rate has been contained, in part by strong office-to-residential conversion activity. German institutional investors have been buying retail and offices in the city centre and a tight housing market means "residential in Copenhagen is still interesting".

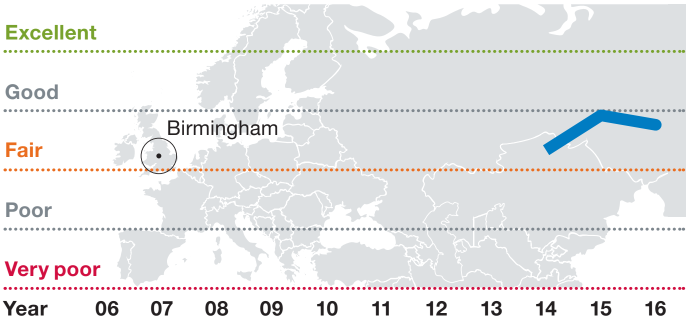
The city also taps into a wider hinterland that includes southern Sweden via the Oresund link and famed bridge. "I believe in the growth of Copenhagen and surrounding region because of the development of sectors such as biotech … intellectual capital is strong there," says a global player.

Others note that though yields are being compressed – those for prime offices fell from 4.50 to 4.25 percent in the last quarter of 2015 – it is still an attractive market. "We are active in Denmark for a combination of offices and retail and we have found plenty of opportunities to deliver good returns within a tight market place."

Longer term, further opportunities are expected to emerge with the development of a new light-rail corridor along the path of Copenhagen's Ring Road 3, linking 11 municipalities.

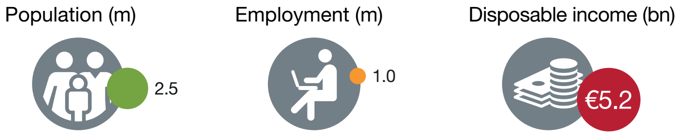
Birmingham (2016: 6) (2015: 6)

Investment prospects, 2006-2016



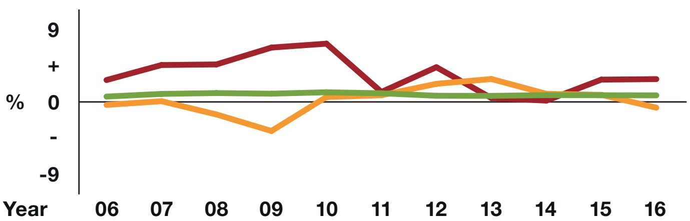
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



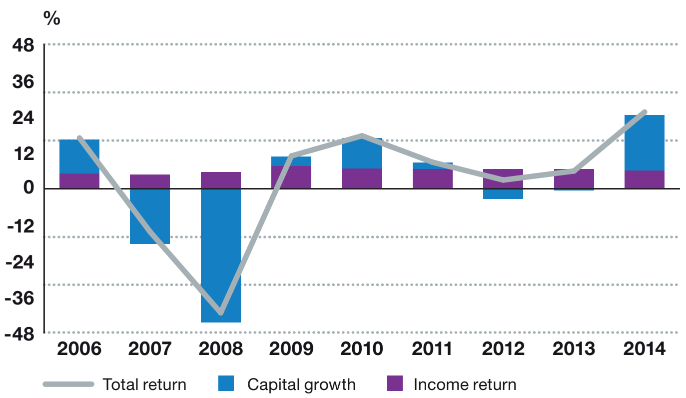
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Britain's second city remains firmly established in the top 10 at Number 6. Like regional centres in a number of other European countries, it is benefiting from offering good value.

"The assets are not as keenly priced as London, and there is not so much competition. But there's still a growth story – not as far along the track as London, and so we're going in at an earlier part in the rental growth cycle," says an international investor.

Birmingham's relative cheapness is also bringing occupiers to its office market; global bank HSBC moved its retail division to the city, taking a 20,000 square metre pre-let at 2 Arena Central in 2015.

"I think it is finally proven that Birmingham is attracting employees and employers from London. At several buildings in Birmingham which we own, the tenants have moved people there because it is cheaper," says an investor.

Rising rents and a dwindling supply of good quality space have prompted several developers to start building or refurbishing offices.

Birmingham is also set to benefit from substantial infrastructure investment, in particular the HS2 high-speed rail line to London, scheduled to open in 2026.

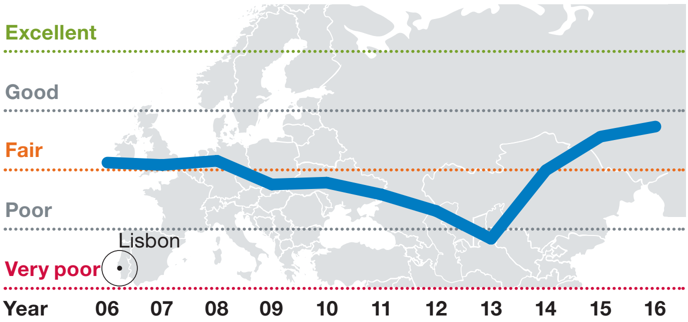
"I believe HS2 will have a major impact in Birmingham," says an interviewee. The £750 million redevelopment of the city's New Street Station opened in September 2015, including a 25,000 square metre John Lewis department store.

The city sits at the western corner of the prime UK logistics location known locally as the Midlands' "golden triangle", where the country's biggest warehouses are situated. A shortage of existing buildings and rising rents have led to a surge in speculative development of big distribution centres across the region.

Housing also offers opportunities: "Private rented residential isn't really there in Birmingham and Manchester yet. We are looking into that," says a European fund manager.

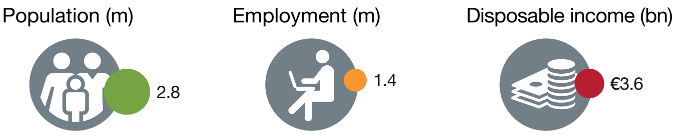
Lisbon (2016: 7) (2015: 9)

Investment prospects, 2006-2016



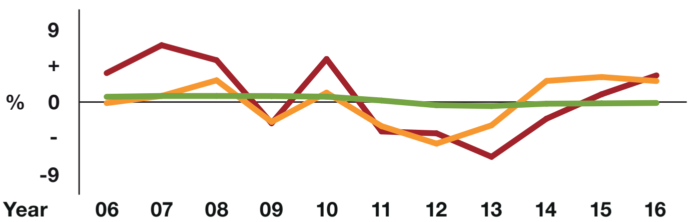
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



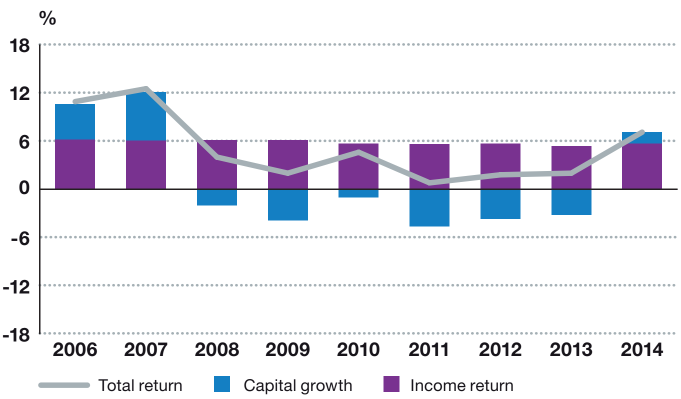
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

"The feeling is that Portugal is on the radar of investors again. Portugal has recovered its credibility."

Lisbon's recovery has been dramatic; international popularity and trans-Atlantic connections have hastened its return to health.

"Transactional services are going through the roof at the moment, particularly on the investment side, with the capital coming into Portugal – and it is all foreign capital," says a local.

The financial crisis wiped out most of the local Portuguese funds, but today international players are jostling for assets. "German funds are still active but are finding it hard to compete with other funds from Singapore, China, Malaysia, Brazil, Angola, USA, UK and Holland."

"The variety of capital is a lot greater and it is no longer just core or core-plus that sells. Value-add and opportunistic are sought after too. Everything sells at the moment, which is a big difference."

Prime Lisbon commercial is reckoned to be "close to the top", seeing some near-5 percent yields. "There is still some value to gather but it is in rental growth rather than yield compression. In non-prime or lesser prime locations there is more room to grow and more value to be had."

As a development destination, Lisbon's prospects are less well regarded at Number 22. However, this may change. "There is a lack of supply, there are a number of cranes on the horizon and that's because there are good fundamentals," says an opportunity fund manager.

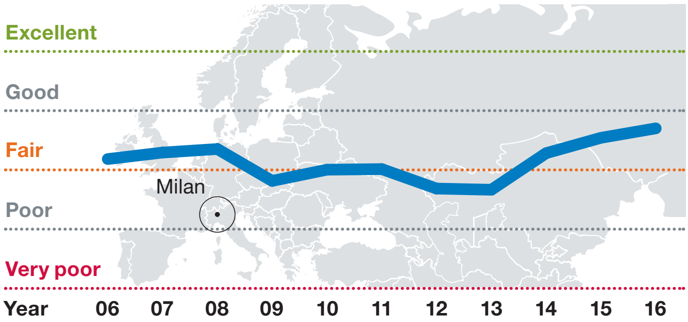
Lisbon's population decline could soon halt too, according to a local: "People were pushed to the suburbs because they could not afford Lisbon rents. Because of lease terms on security of tenure landlords would rather not lease than have to let to someone indefinitely."

However, Portugal's reform of its lease legislation in 2012 has allowed a phased move of controlled rents to market levels and given landlords greater freedom to evict tenants when structural work is needed on a property. These changes are encouraging more residential building and refurbishment. "Development is focusing on the higher end of the market. This will have to change because we can't just build for millionaires. Younger people want to live in the city."

Milan (2016: 8)

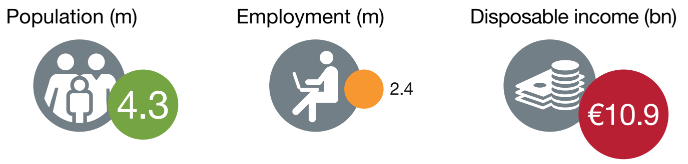
(2015: 12)

Investment prospects, 2006-2016



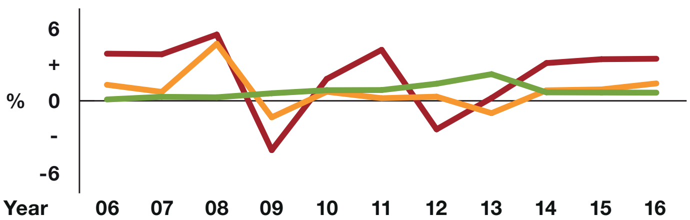
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



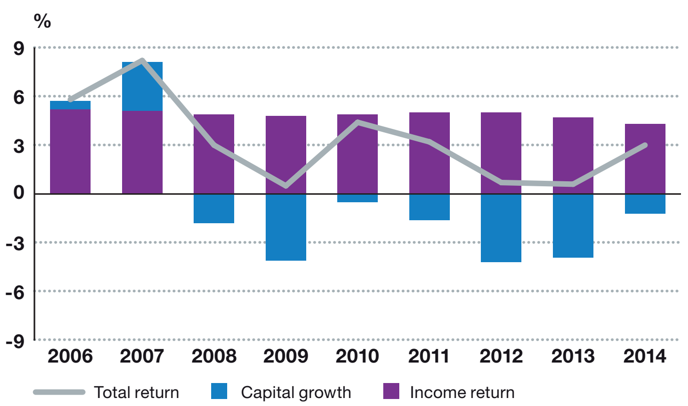
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

As interest in distressed opportunities refocuses on Italy, Milan is an increasingly popular target. "The economy there is strong."

Italy's main industrial and financial centre, Milan was the eighth most active real estate market in Europe, with €4 billion invested between Q4 2014 and Q3 2015.

Overseas investors are pouring capital into the city: Qatar Holding consolidated its interest in Milan's new Porta Nuova project, while China's Fosun group spent €345 million on its first Italian purchase, UniCredit's former headquarters, the historic Palazzo Broggi, and Partners Group acquired two prime office properties in the centre of Milan for €233 million.

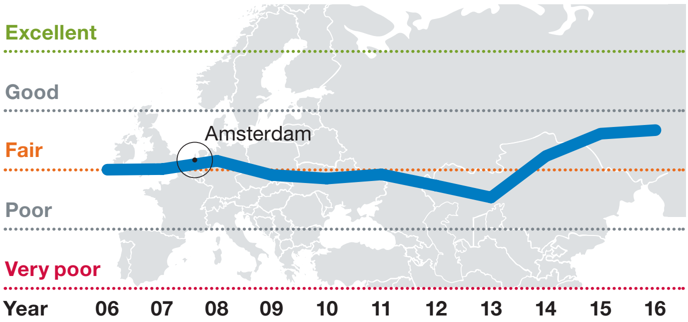
The city's development prospects have taken a big leap, up nine places to Number 14. "If you look at Milan, you've got a lot of occupiers moving to modern space on the edge of the CBD, freeing up a lot of redundant buildings in the CBD, and that's going to present some opportunities in terms of positioning," says an investor.

The opportunities are fairly specific: "The best prospects in the next 12 months are modern offices near public transportation, shopping malls, luxury shops (street retail) and hotels."

Favoured areas include those close to Milan's central station and Milan CityLife, the new urban district being developed by Italian insurer Generali on the site that formerly housed Milan's trade fair, not far from the city centre.

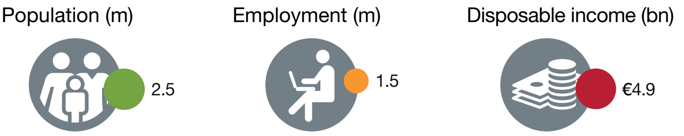
Amsterdam (2016: 9) (2015: 8)

Investment prospects, 2006-2016



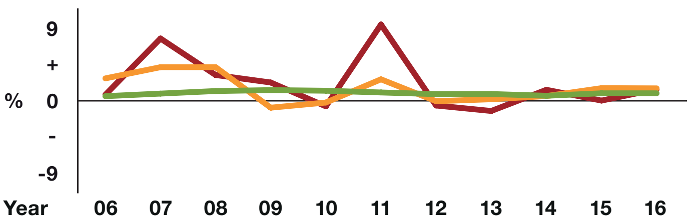
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



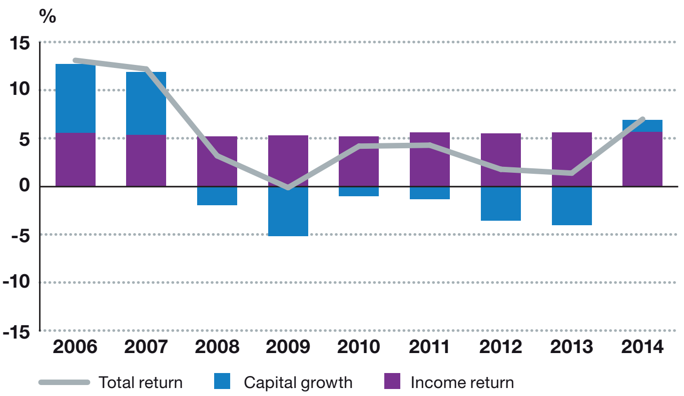
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

The Dutch property market's recovery is firmly embedded, and Amsterdam holds its place in the top 10 cities for the second year running.

"Amsterdam is much bigger and more important than you see at first sight," says an investor.

The price differential that has excited investors for the past two years has now largely been eroded, and the Dutch capital is firmly in the sights of a range of investors that now includes international institutions.

"You're starting to see more core investors coming into the market," says a local. "Asian money is entering the market. It's getting more difficult to buy assets. There is much more competition."

Still-high office vacancy is expected to decline gradually if the Dutch economy grows in line with the 2 percent forecast in 2016, and consumer confidence is improving. Yields have come in to below 6 percent for prime office property and to around 4 percent for high street shops. Investors are beginning to consider whether values have reached their limit.

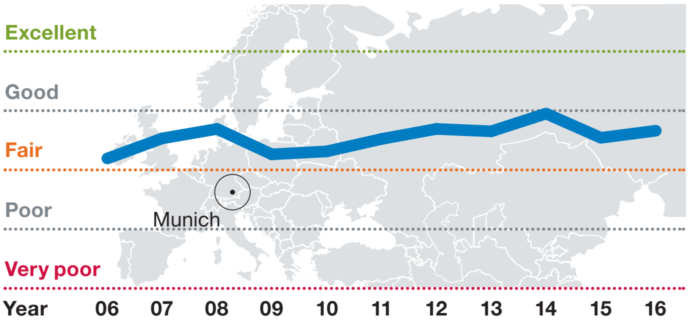
A Dutch interviewee says: "Amsterdam still has yields higher than a lot of other cities. I think people believe that we still have some room for further growth – although some people are selling because they believe things could already be at the peak."

Residential is very much a hot sector, with several interviewees citing developing for the private rented sector as an area with strong growth potential. One local interviewee says that his company will exit the office market and focus instead on the residential sector and student housing.

CBRE research shows investors responded to the shortage of housing supply by ploughing €774 million into residential development during the second and third quarters of 2015. Most activity has so far concentrated on Amsterdam, but the other cities in the "Holland Metropole" conurbation – Rotterdam, The Hague and Utrecht – are also expected to experience increased levels of development and higher rents.

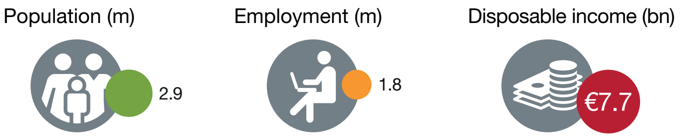
Munich (2016: 10) (2015: 11)

Investment prospects, 2006-2016



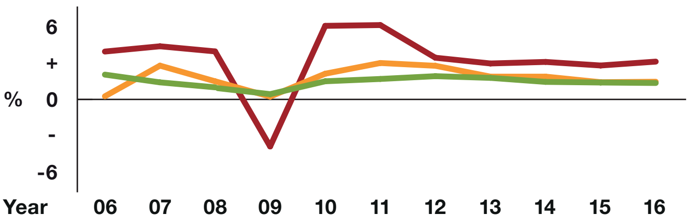
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



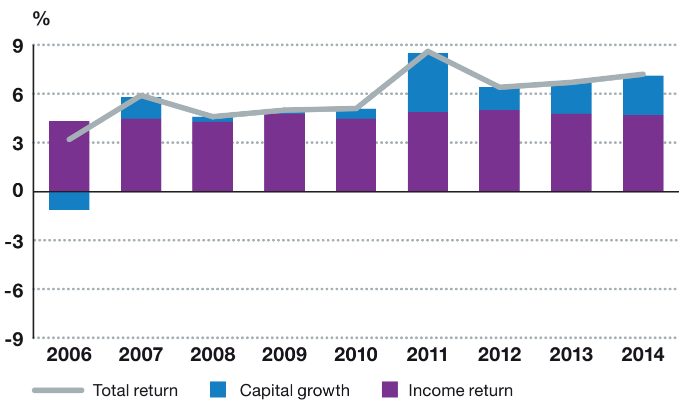
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

The Bavarian capital is the most expensive of the German real estate markets and one of the priciest in Europe, but its robust economy and strong defensive qualities make it sufficiently popular with investors to remain in the top 10.

A pan-European fund manager says: "Where you invest is how you protect yourself. When money starts flowing again after the next market correction, it will start in London, Paris, Berlin and Munich."

That is why investors are prepared to pay eye-wateringly sharp yields of 3.75 percent for prime offices. The occupational market is strong too: "It's very healthy with a good spread of occupiers and a very low vacancy rate. It is impossible to develop in the city centre so it will continue to be a healthy market," says an investor.

"Healthy" and "stable" are the adjectives most frequently employed by interviewees when describing the city, although one investor puts it in the "overheated" category along with London and Paris.

The city ranks Number 2 for development and only some 153,600 square metres will be added to the office stock in 2016. "It's lack of possibilities – Munich is very restrictive in terms of zoning and where you are allowed to develop," explains a German developer.

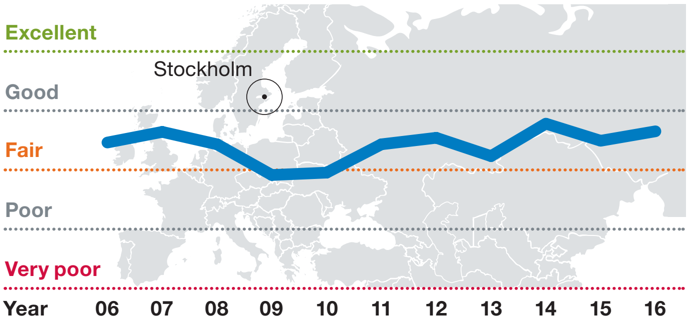
Some observers believe that the imbalance between supply and demand must lead to higher rents: "Germany, particularly Munich, is a market we like a lot. That's one of the few rental growth stories on the continent," says an international investor.

The city's retail boasts the highest rents and the lowest yields for high street property in Germany, but few investments come onto the market. Logistics property is also in short supply, although there is a growing market in hotel investments.

"Munich is solid as long as you can secure assets, and that's the big challenge."

Stockholm (2016: 11) (2015: 15)

Investment prospects, 2006-2016

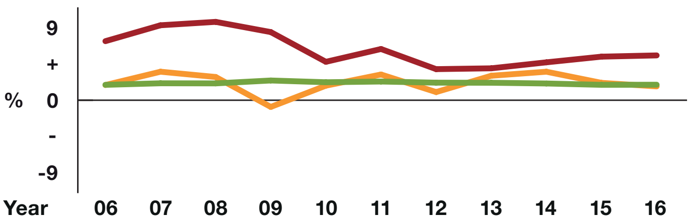


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

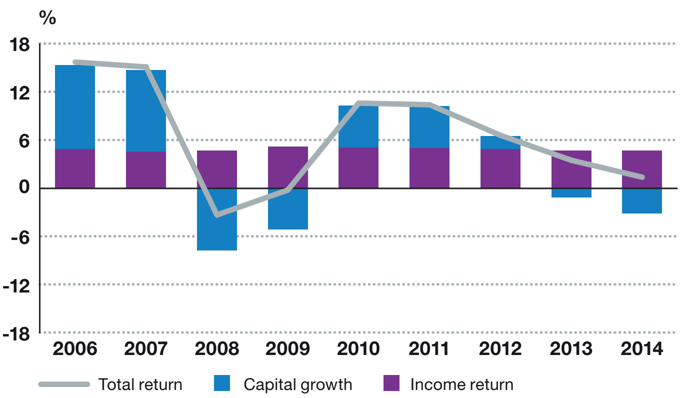
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Stockholm has risen up the investment league to Number 11, but ranks Number 4 for development, beaten only by three German cities: Berlin, Munich and Hamburg.

"Prospects are good. There are very good levels of activity. A record year is expected again across all sectors," says a local. "There are two drivers: institutional capital and its hunt for yield from real assets; and financing costs that are so low."

Demand for more efficient space is helping drive development: "Companies are leaving outdated space and going to modern offices. They are leaving the city centre of Stockholm to obtain bigger floor plates – the supply of space in central Stockholm is very limited. The trigger was the availability of good space in the suburbs with good public transportation."

Global capital has also started to flow in, though domestic players still dominate. "It is now 80 percent Swedish and 20 percent international. International investors buy retail properties and big portfolios and the rest of the market is more or less left to Swedish investors," explains a local.

"The volume is comparable with 2007. It is definitely a very active market for offices and multifamily housing investments," says another.

Urbanisation is another pressure on Stockholm. The city has one of the highest population growth rates in Europe, with a 1.5 percent increase forecast for 2016 according to Moody's Analytics.

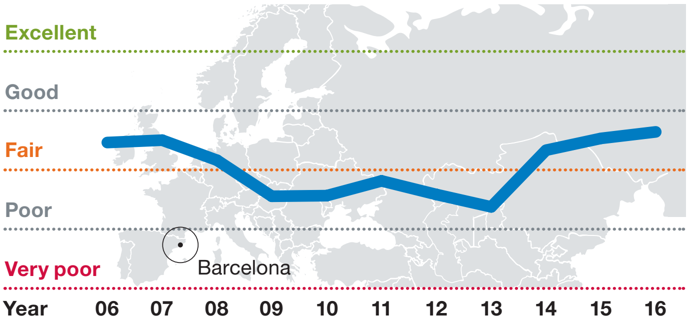
Immigration is helping fuel that growth and is becoming a significant issue in Sweden; the country has accepted more asylum seekers per capita of existing population than other European countries.

This is putting additional pressure on housing, exacerbated by a tight planning regime. The residential market is red-hot, with prices rising 20 percent annually.

"We always look to the alternatives to create residential buildings and apartments. Even a well-functioning shopping centre might be replaced by housing because of the increased value of residential and the tough competition for retail."

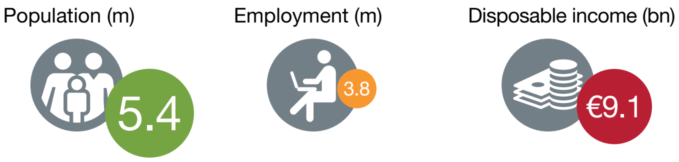
Barcelona (2016: 12) (2015: 13)

Investment prospects, 2006-2016



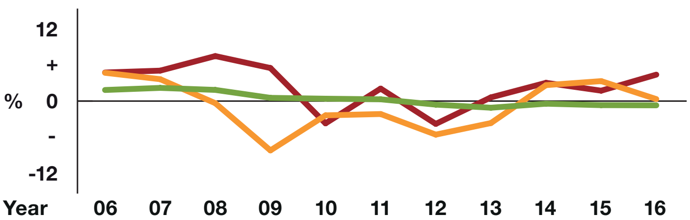
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



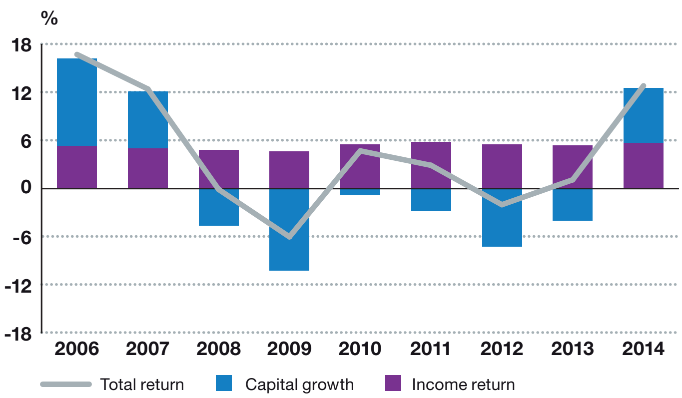
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Barcelona has moved up a couple of notches in the rankings, to Numbers 12 and 19 for investment and development respectively.

"Barcelona is a bit delayed in the cycle but with a very positive evolution in the last six months," one local investor comments.

But competition is frustrating some would-be investors. "We see big opportunities; however when assets come to the market there are strong local players who are making large bids," says a foreign player.

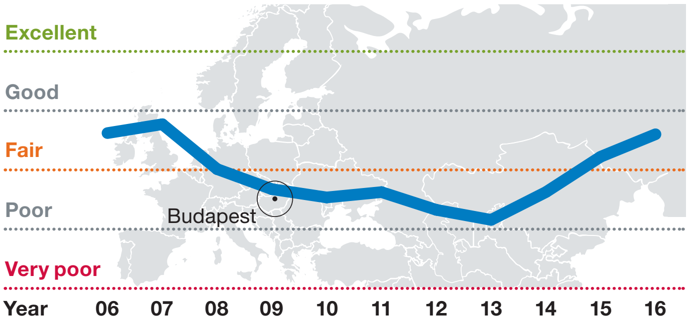
Although the investment market has recovered substantially, rents have not yet caught up. "30 percent lower today than the long-term trend line."

The shortage of prime office stock may help: "You are seeing lots of demand in places like Barcelona and Madrid and people are not building even in the best locations, so that should lead to increased rents," says a foreign investor.

Housebuilding, the cause of much of the country's previous distress, has contracted dramatically, but is finding a new and more realistic level. "It is a very positive market because it's coming from such a low base. When you add to that access to the mortgage market – people getting 80 percent mortgages at 1 percent interest rate margins – two years ago there was no mortgage lending at all."

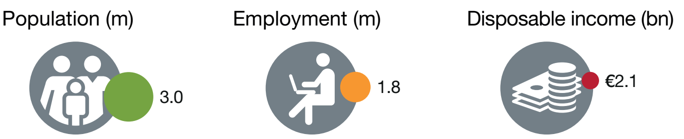
Budapest (2016: 13) (2015: 22)

Investment prospects, 2006-2016



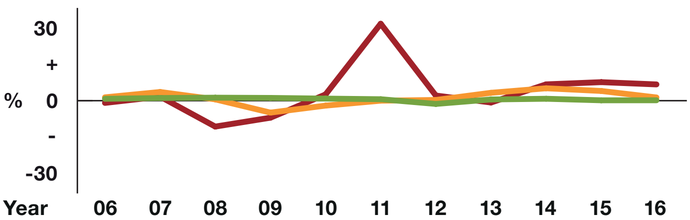
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



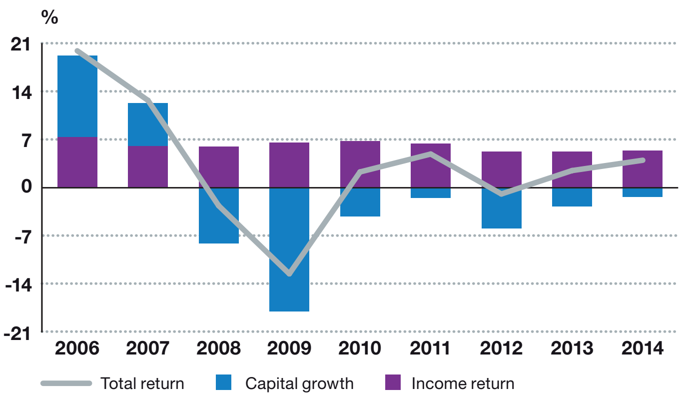
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

There is burgeoning interest in Budapest. "Despite ongoing political risk in Hungary, property investors have decided there is a good story there and it is time to get in."

Despite troubling footage of Hungarian soldiers erecting razor wire fences to keep out refugees and the rhetoric of the country's nationalist politicians, Budapest is this year's top pick among the CEE cities for investment, gaining nine places to Number 13.

"If you are not averse to a bit of risk you can buy a half-empty office building in a good location cheaply and have a good chance of letting it up and selling on to a more mainstream investor. It is the classic opportunity play," says a CEE-based investor.

"Budapest is a real city and the Hungarian economy is okay. We like the dynamic," says an international investor. "You can buy good assets at 8 percent-plus yields when the same assets in Poland would be trading at 5.5 percent yields."

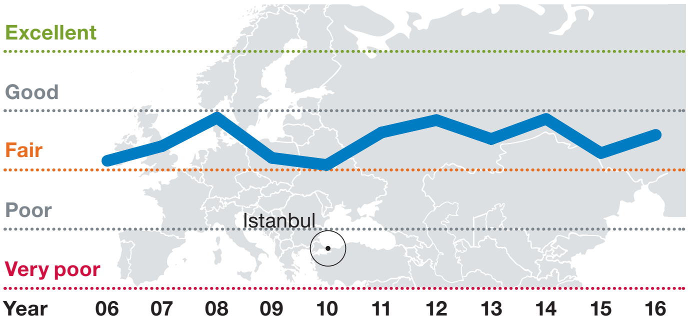
The prospects for development are much more downbeat, with Budapest ranked at Number 26, ahead of only Moscow and Athens.

Despite this more positive sentiment the quantity of capital allocated to Budapest has so far been modest, only €295 million over the year ended Q3 2015.

Some are still deterred by the risk: "In Hungary the regime is not particularly investor-friendly." And, "You don't really know what legislation might be put in place that poses a risk to what you can do with your property."

Istanbul (2016: 14) (2015: 20)

Investment prospects, 2006-2016

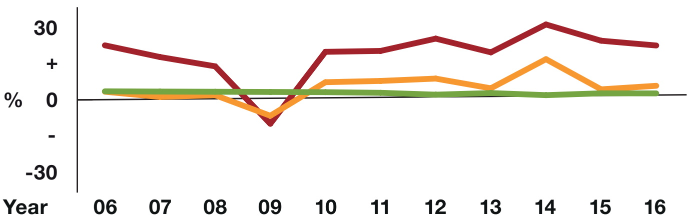


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics
Note: Income for Istanbul is total wages and salaries, not disposable income.

All-property return, 2006-2014

MSCI does not produce an index for Istanbul.

Istanbul has scale on its side. With a population of 15 million, it is the largest city in *Emerging Trends Europe*'s survey. It also has a young demographic and a real estate stock in need of upgrading.

However, "there are also some political risks so we are a little bit hesitant", says an international investor who is considering going into Turkey. These risks are also deterring others.

"I believe that it will be more of the same in 2016. I still think the global economic backdrop is uncertain. Turkey has political issues and uncertainty. I don't think any of these issues are going to be solved in the short term," says a local.

Last November's general election, which saw the AKP, Turkey's Justice and Development Party, regain a majority, may provide some political stability in the short term, but it may take longer for the investment environment to conform to the criteria of institutional investors.

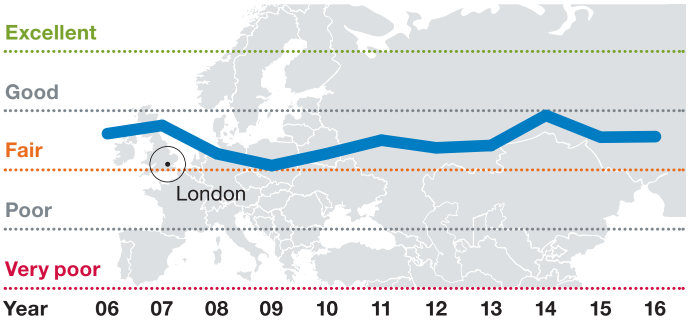
"The Turkish market has always attracted medium-to-high-risk private investors and not so many institutional investors. There are many reasons, such as the legal structure and lack of suitable product."

Investors focus on new-build property because of the often fragmented title of existing buildings. However, selectively, refurbishments can also provide opportunities.

Although office take-up is rising, prices are expected to "stay slack" or fall slightly over 2016. Istanbul has a substantial development pipeline which is keeping rents stable. By the second quarter of 2015 there were 1.9 million square metres of space under construction in Istanbul, according to Cushman & Wakefield research, most of it in the CBD and Atasehir, an up-and-coming business and residential suburb in the east of the city.

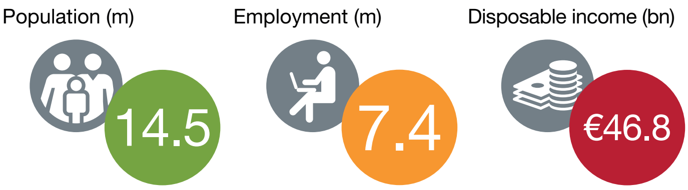
London (2016: 15) (2015: 10)

Investment prospects, 2006-2016



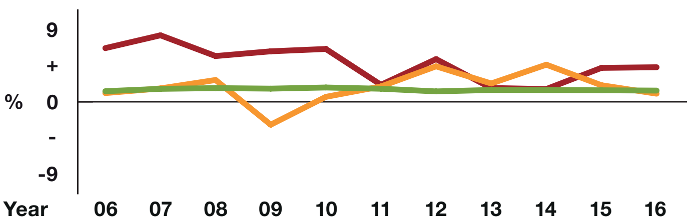
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



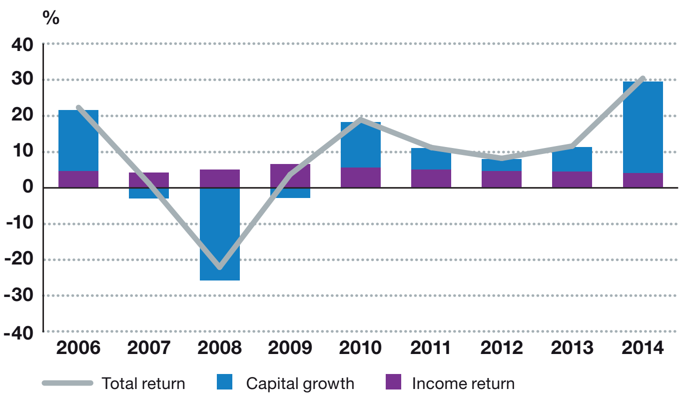
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Have London property prices finally reached their peak? The city's slide down five places to a lowly Number 15 for investment prospects this year suggests that an increasing number of investors are calling the market.

"Current prices in London are way above where they should be if you follow the normal trend line," says an international investor.

Others also believe that yield compression in the UK capital is either at an end or likely to tail off in 2016; several are looking to offload large chunks of their London portfolios.

"Suddenly everybody is beginning to look to sell. The theory is that the smart Americans are taking their chips off the table and are now looking more to mainland Europe, and in particular parts of Germany and southern Europe, to deploy capital in 2016. The big test for London is how much of this stock will be mopped up," says an investor.

Nevertheless, the liquidity and scale of the market, together with relatively robust economic performance, are still powerful arguments in its favour. Far more capital – €47 billion – was deployed in London than any other European city over the year to Q3 2015.

The city remains the first choice in Europe for many international investors focused on wealth preservation: "One layer of capital that's been most visible in London is safe harbour capital. Returns are not driving the rationale in this case."

"There is still a tremendous wave of capital coming into London. As long as interest rates remain in this zone, even if you are buying properties at 3.5 percent, people assess that it is worth the risk," says a local.

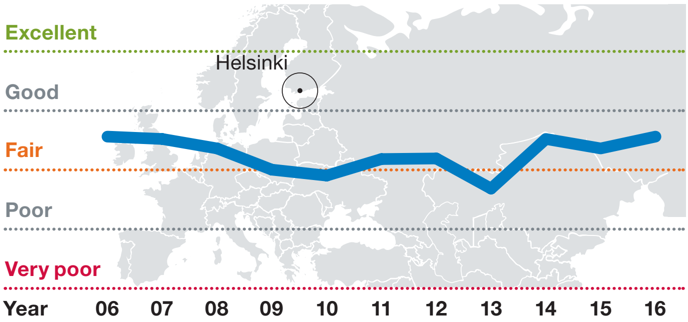
Another investor adds: "City offices are clearly steeply priced and also West End retail on 2 to 3 percent is aggressively priced, but if that works for your investment criteria, why not do it?"

The boom in the central London residential sales market has ended following changes to the property transfer tax in late 2014. These introduced a progressive levy, which has hit higher-priced properties. Says an interviewee: "The residential sector in London, which was very popular with foreign buyers, is already flat."

By contrast, private rented apartments are seen as an area of substantial future growth as London struggles to house its growing population.

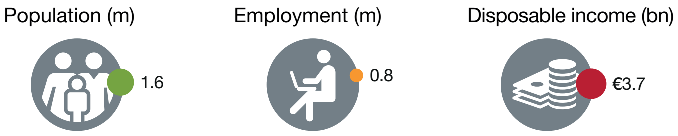
Helsinki (2016: 16) (2015: 17)

Investment prospects, 2006-2016



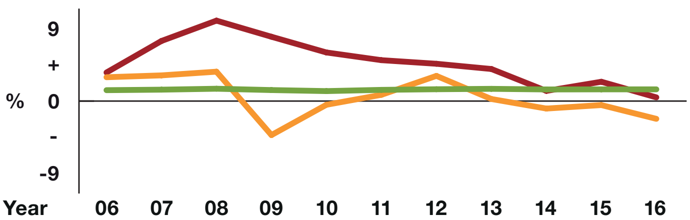
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014

MSCI does not produce an index for Helsinki.

Helsinki's investment prospects have climbed one place, to Number 16.

On the positive side, capital is expected to flow into Finland because risk premiums are good, according to one Nordic investor. Another notes: "Transactions in Finland are at a high level and this will remain so for the next 12 months and maybe longer, despite the economic situation."

Another remarks that "global capital flows will increase activity in Finland, boosting prices. International capital will have an effect little by little in Finland, which will strengthen competition and further move the focus from prime markets to secondary markets."

The relatively optimistic ranking of Finland's capital city is somewhat at odds with other opinions. The country's economy has been ailing badly for three years, and the new coalition government that was formed in 2015 is trying to implement an austerity programme.

"Given what has happened in Finland, which is influenced by its neighbour Russia, the economy is not seeing a path to recovery. It is not somewhere we will be beating a rapid march to," says a European investor.

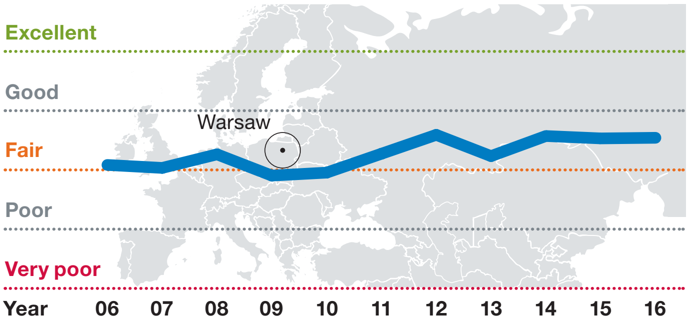
Other factors contributing to a negative view of Helsinki include poor availability of assets and political uncertainty. "Helsinki is challenging."

Prime office yields are 5 percent in the Helsinki CBD but 4.75 percent for the best assets. That is despite an increase in vacant office space; according to consultant Catella the rate is 7.2 percent in downtown Helsinki and 10 percent in the CBD. Take-up is weak and rents have been falling even in prime areas.

However, urbanisation is a growing influence and in 2014 Helsinki's population rose by about 20,000, creating demand for residential space. Change of use from office to residential or hotels has been the solution for a number of empty office buildings. One investor notes: "The economy is not an issue in Helsinki since workplaces will increasingly concentrate to the capital region."

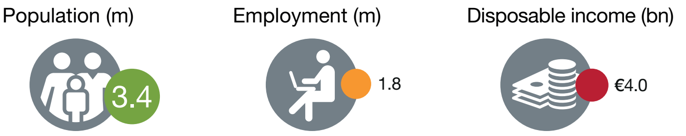
Warsaw (2016: 17) (2015: 14)

Investment prospects, 2006-2016



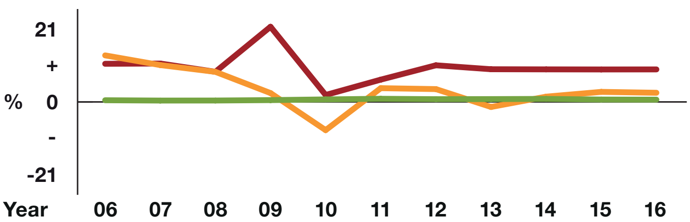
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



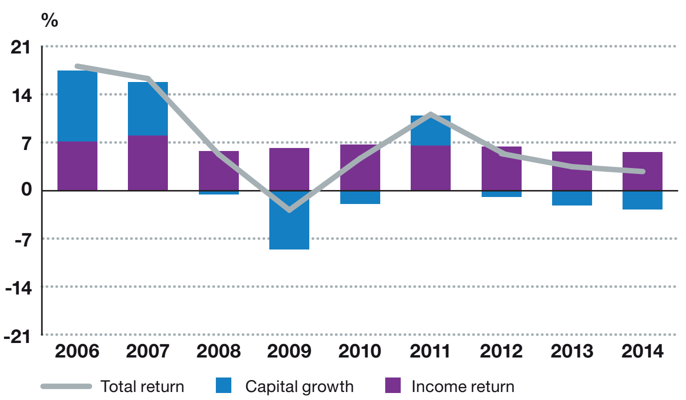
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

While some investors are attracted by the vigour of the Polish capital's real estate market, others are deterred by its volatility.

"Poland is a shining star in the CEE region," says a US investor. With a population of 40 million and having remained recession-free through the financial crisis, Poland has proved enticing to buyers seeking growth potential.

"I have always believed in the economic growth story of Poland and it has been frustrating trying to raise capital for that market because all people wanted to talk about was Spain," says a fund manager.

Nonetheless Warsaw has fallen three places to Number 17 in this year's investment ranking and is Number 21 for development prospects.

"Overrated and too volatile," is the verdict of one interviewee. Another sceptic says: "I think it is moving too far too fast. Poland has a new government and we will have to see how that affects the economy."

"It's a good moment to sell assets," says a pan-European investor, citing high pricing.

In Warsaw, office yields have continued to harden to less than 6 percent, but despite strong take-up, a flood of development due to be completed in 2016 is likely to see vacancy rates increase from their current level of around 13 percent; rents are already falling.

"There is a big discrepancy between good and low quality buildings, and the gap will widen," says a local, noting that tenants are willing to pay €20–23 per square metre for modern buildings but only €12–14 for low quality ones.

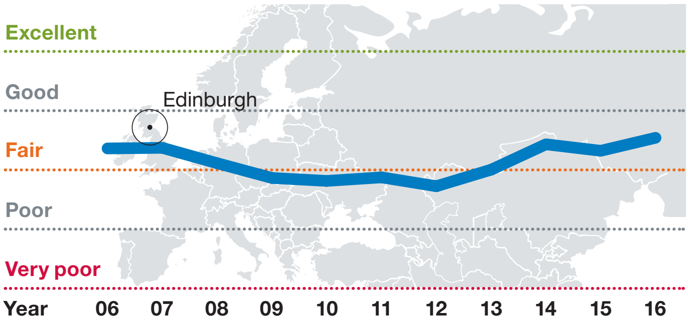
A shift of focus away from Warsaw is also in evidence: "2016 will be a year for development in regional cities such as Łódź, Poznaź and Gdaźsk."

Comparatively low wages and proximity to German consumers have also contributed to a booming market in logistics property. There is fierce competition to buy well-let assets: "You have an Amazon shed in Poland trading for a yield of less than 5 percent. That is just unheard of," says a fund manager.

Others see opportunities in regenerating Poland's older shopping centres. Warsaw's retail market is currently stable, but there are some 134,900 square metres of new space due to open over the next two years.

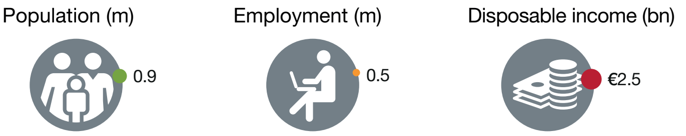
Edinburgh (2016: 18) (2015: 19)

Investment prospects, 2006-2016



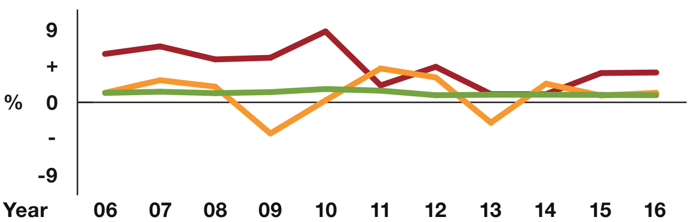
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



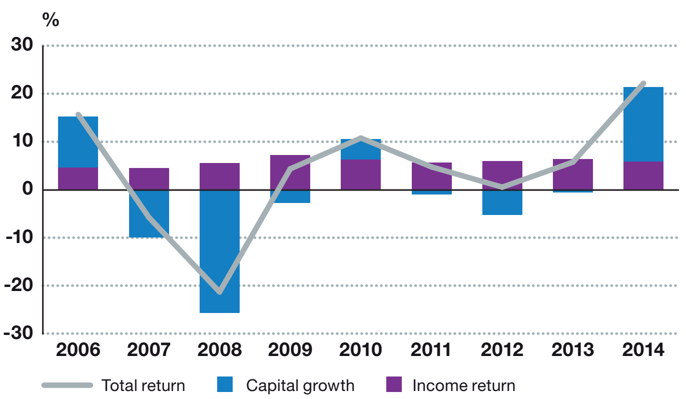
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Concerns over Scottish politics are dampening confidence in Edinburgh's property market. "The devolution question has not gone away and is definitely a consideration if you are looking at longer-term, large-scale investments," says an international investor.

The Scottish National Party's landslide victory in its own backyard in May's UK general election has reignited the flame of independence that many thought quenched after the country decided to remain part of the UK in the 2014 referendum.

Even if another plebiscite is ruled out in the short term, the Scottish government in Edinburgh is likely to be granted a greater degree of economic autonomy.

"They will need to raise taxes and real estate is the one thing you cannot move out of the country," warns a London-based investor.

But not everyone is deterred. "We like Edinburgh retail and we have bought some of that recently," says another.

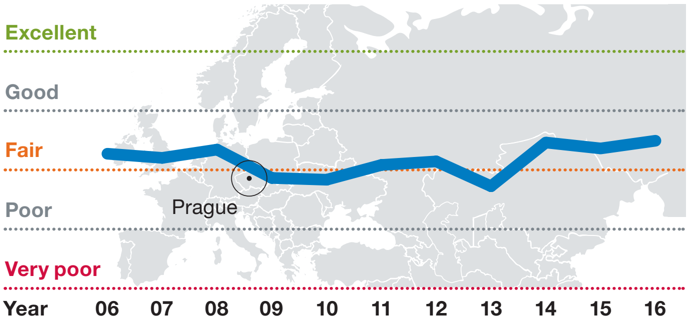
A UK fund manager notes: "For those investors, either domestic or regional, looking beyond London, Edinburgh would definitely be on their radar as a very well-established commercial centre. There will be some adjustment in Edinburgh yields for the perceived uncertainty, but not a huge amount."

The developers of the £850 million St James mixed-use scheme are seeking funding for what would be Edinburgh's biggest city centre development for many years, providing 40,000 square metres of shops as well as apartments, offices and a hotel.

A local says that the appetite for building projects demonstrates the strength of Edinburgh's economy: "The underlying dynamic is fundamentally sound. The hotel and tourist trade is doing well and there is a degree more robustness in the financial sector. We will see more development," he predicts.

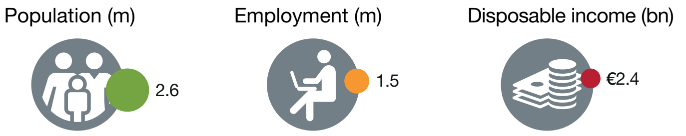
Prague (2016: 19) (2015: 18)

Investment prospects, 2006-2016



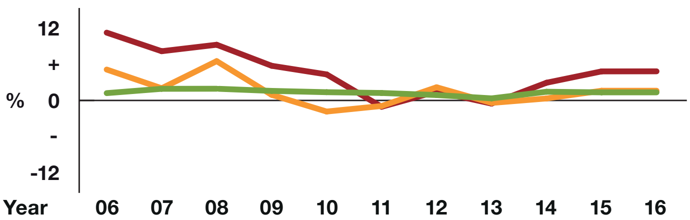
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



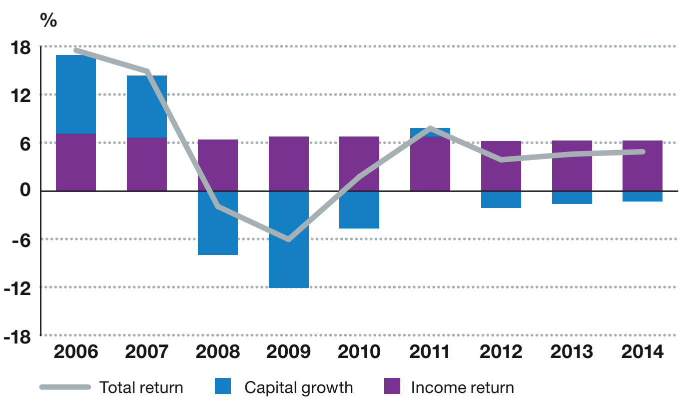
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Despite its position at Number 19 for investment prospects, there are signs of increased interest in the Czech Republic among international real estate investors.

A local says: "As pricing gets hotter in traditional markets we expect that money to start looking more into central Europe to get the returns. We think this market will become more of a serious and safe option for institutional money."

Yields have continued to harden, with high street retail properties fetching 4.5 percent, offices 5.75 percent and further "strong compression" expected.

"Prices will go up by 10 percent and we will see the first transaction in Prague or Warsaw at a yield of sub-5 percent in the office sector."

The problem facing foreign institutional buyers is finding assets that fulfil their investment criteria: "The issue you have in these CEE markets is one of scale," complains a pan-European fund manager.

Demand from cross-border buyers is boosting investment volumes, with Prague garnering €1.5 billion in the year to Q3 2015.

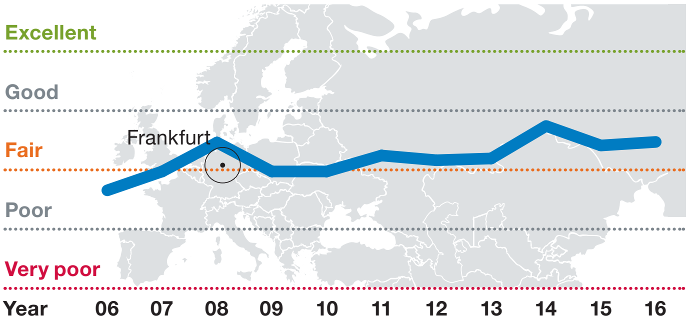
But that total includes the €570 million sale of a majority stake in the city's Palladium shopping centre to Germany's Union Investment, at the time the largest ever single asset transaction in Central and Eastern Europe.

Prague has slumped seven places in the development ranking to Number 20, however. Office vacancy remains high at around 16 percent and though headline rents are static, developers are offering significant incentives to attract tenants.

A slowdown in development and strong occupier take-up from the thriving domestic technology sector is set to push vacancies down over the course of 2016. "It seems to be a bright atmosphere for business at the moment in this region," says a local investor.

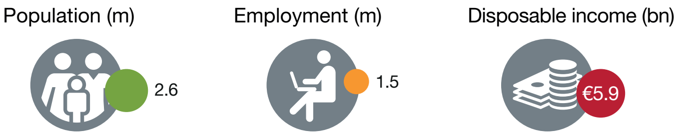
Frankfurt (2016: 20) (2015: 16)

Investment prospects, 2006-2016



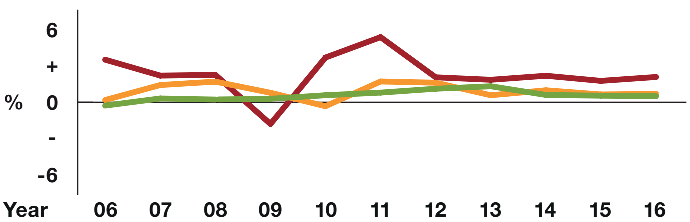
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



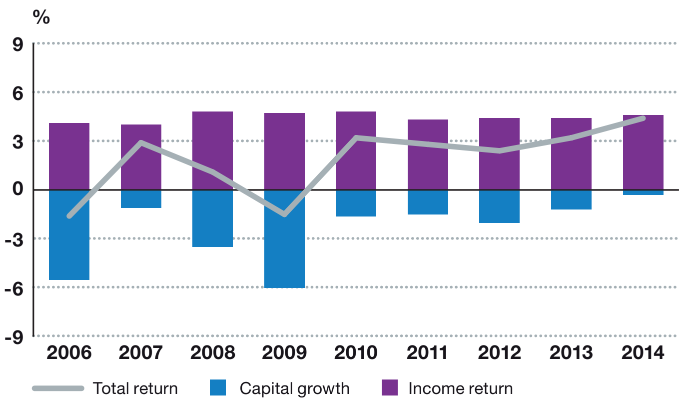
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

"In Germany, Berlin, Hamburg and Munich interest me more than Frankfurt," says an investor. That apparent indifference to the charms of Germany's main financial centre is reflected in its tumble to Number 20 in this year's ranking.

Nevertheless Frankfurt remains the fourth biggest property investment market in Europe, with nearly €7 billion invested over the past year, and several interviewees place it near the top of their list of targets for 2016.

An explanation for this contradiction may be found in the divergence of the city's investment and occupational markets. An influx of foreign buyers has compressed prime office yields to 4.35 percent; investors are increasingly forced to consider less expensive core-plus property.

"This year we have seen foreign investors having a share of more than 60 percent of transactions in Germany. If the Chinese get interested that will drive the prices even higher here."

Meanwhile, Frankfurt's office take-up was weak in 2015 and its vacancy rate of over 11 percent was the highest among the big German cities. "There has not been a lot of big leasing activity this year and we don't see new entrants in the tech sector. They like to be in Berlin."

The city's reliance on the financial sector is now a drawback. German banks are under severe pressure; Deutsche Bank will be cutting a quarter of its workforce over five years and Germany's regulator has said that smaller and mid-sized banks are at risk of an "alarming" profit fall.

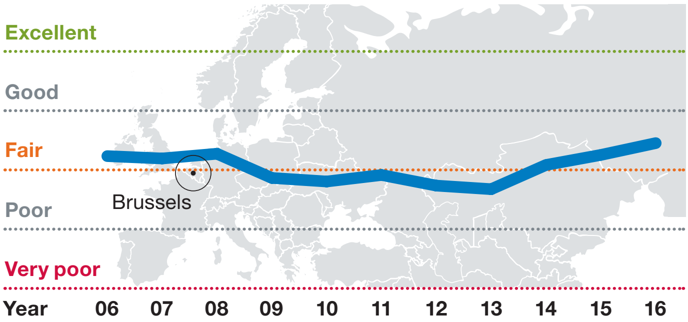
"That sector needs to have a good two or three years for Frankfurt to do well. It might surprise us, but it doesn't look great at the moment."

Office demand is concentrating on new buildings, which are in short supply. "The demand for more efficient space is rising. The phenomenon is significantly observable in cities such as Frankfurt," says an interviewee.

Together with the growth of the city's residential market, that could instigate more construction; Frankfurt is ranked Number 11 for development prospects in this year's survey.

Brussels (2016: 21) (2015: 21)

Investment prospects, 2006-2016

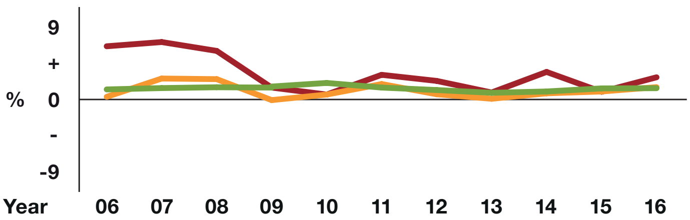


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

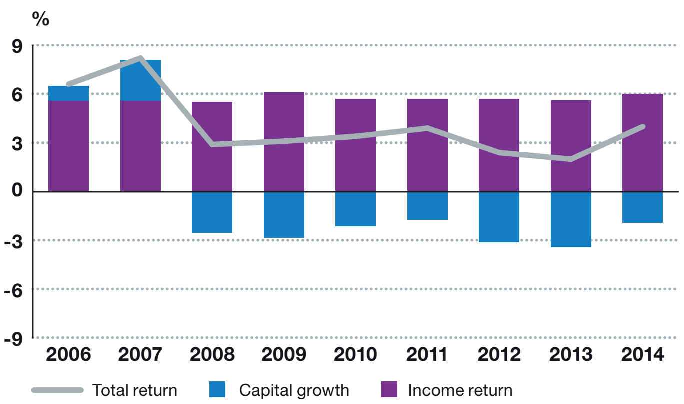
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Well-priced assets in the Belgian capital are becoming difficult to find. "Not enough investment properties are available that meet our investment criteria at an acceptable price," complains a local investor.

Belgian real estate investment had a bumper year in 2015 with continued yield compression in the retail and office sectors. "Yields will stay very low and foreign investors are back in the Belgian market."

Prospects for occupational markets are more subdued, however, which is reflected in Brussels's lowly investment ranking at Number 21 and its 13-place fall down the development table to Number 23.

In the office sector yields for long-let buildings are at an all-time low of 4.25 percent. Take-up in Brussels was weak in 2015, but several large public sector deals are expected and could provide it with a boost. "Brussels is strongly connected to government and public use," says a local.

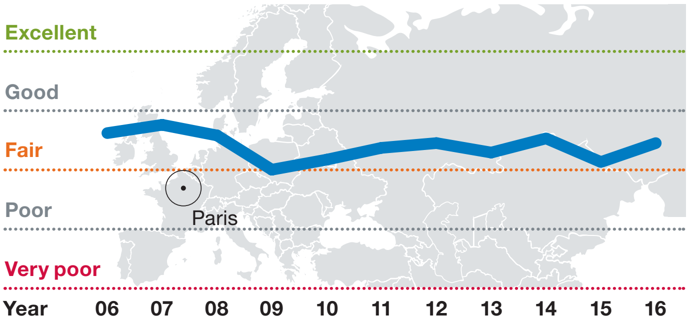
Meanwhile, office vacancy has fallen to around 9 percent, in part due to the conversion of older office space to residential use.

Demand for retail assets is strong and prime yields have fallen as low as 3.85 percent in Brussels, but leasing activity has been subdued because weak wage growth continues to undermine occupier confidence. "Retail has been suffering a little bit after being an upward market for a long time."

The supply of new shops is limited at present, but that could soon change. The 41,000 square metre Docks Bruxsel shopping centre is due for completion in 2016 with two other large Brussels malls in the pipeline. "That will be disruptive to the retail market," predicts a local developer.

Paris (2016: 22) (2015: 24)

Investment prospects, 2006-2016

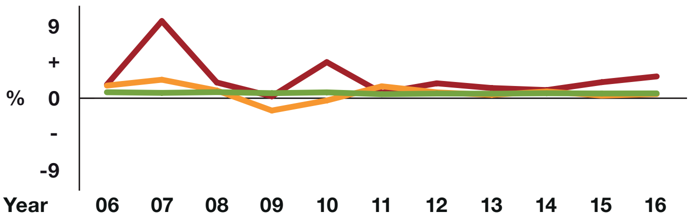


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

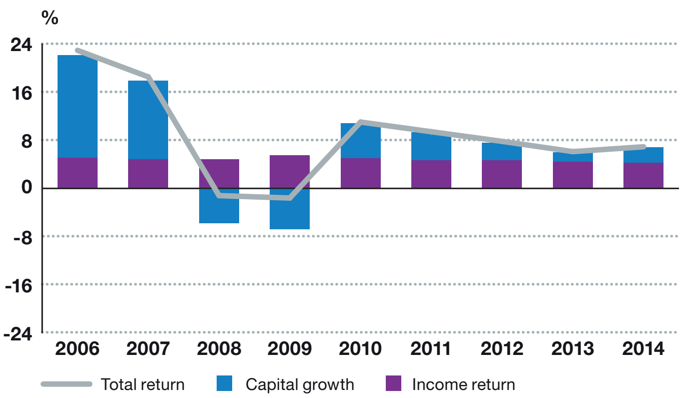
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

A top-10 ranking continues to elude Paris. The City of Light still polarises opinions: from "too expensive, political instability", and "would approach Paris with caution" to "Paris offices never give anyone bad memories".

However, it is still surprising that sentiment puts Paris's prospects at a lowly Number 22, given the level of investment it attracts: the third most active real estate market in Europe, it saw €10 billion traded over the year to end-Q3 2015.

And, according to *Emerging Trends Europe* interviewees, it remains a go-to destination for 2016. "Paris is a global city and is a magnet for investment. I would put it among the top seven destinations for capital in the world. This is partly because of its liquidity and depth. In Paris the quantum is huge," explains one.

This weight of capital also encourages an apparent misalignment of the investment and letting markets. Paris's office vacancy rates are 10-12 percent and not expected to change in 2016.

"There is a paradox in the Parisian real estate market as there is a high level of demand to acquire prime assets but less demand from tenants."

The yield compression in the office market means that "you have to make aggressive assumptions about rental growth, factoring in 10 percent a year to justify the price being paid," says a sovereign wealth fund.

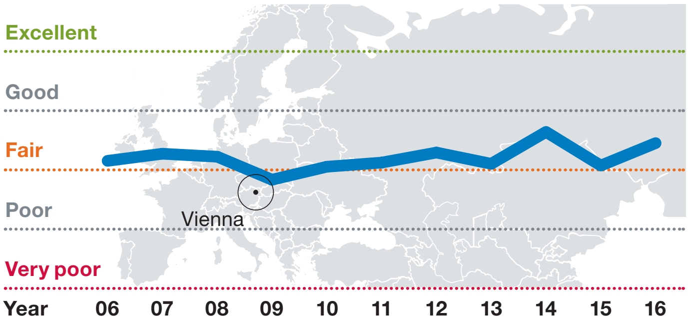
But this does not put everyone off: "We are planning on going into France. It is a completely overcrowded market, but like the Belgian market, if you go there for 20-30 years you can make a living."

All this makes other investment sectors attractive too, including prime retail, logistics, residential and hotels – "Paris is under-hoteled."

"The caveat now is what effect terrorism has. It might impact both retail and hotels, but this is not just a problem for Paris."

Vienna (2016: 23) (2015: 26)

Investment prospects, 2006-2016

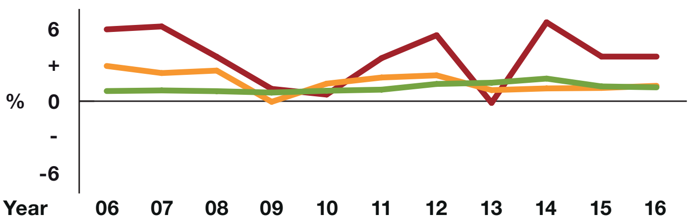


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

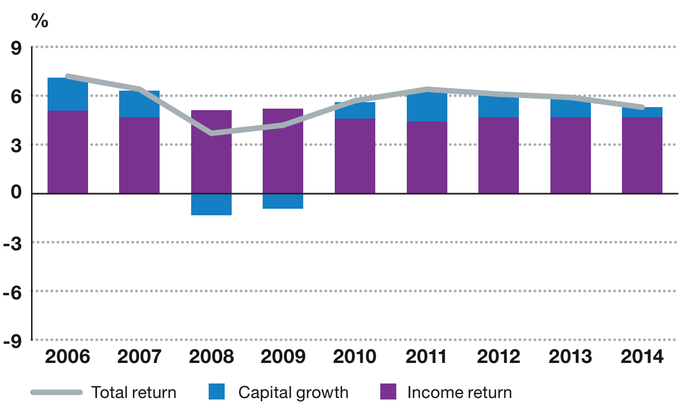
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Vienna improved on its investment ranking by three places this year, rising to Number 23.

Locals are optimistic; Austrian GDP growth is predicted to pick up to 1.5 percent in 2016, driven by strong exports, continued government spending and a gradual improvement in consumer confidence.

Vienna remains a strong retail location, and yields for prime high street locations have fallen below 4 percent, but it is the office sector that is singled out by several interviewees as offering potential to drive returns.

"It is a very stable big city, there is no reason yields should be where they are," says an international investor.

German funds remain the most active investors in the Austrian market, but there is increased interest from Asian and Russian buyers. "We see an ongoing trend to decreasing yields in the commercial sector due to high demand," says a local player.

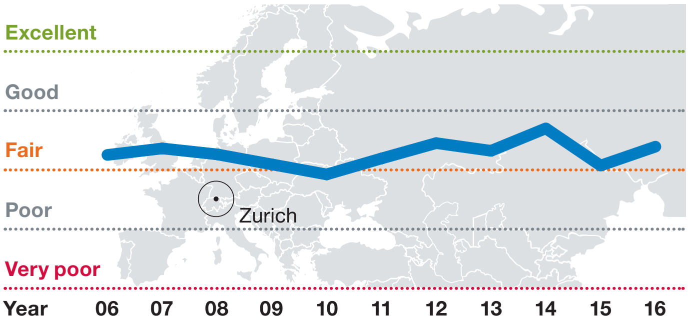
Occupier demand for offices in Vienna is also generally agreed to outstrip supply, which may account for the city's improved ranking for development potential – up seven places to Number 10.

Of the 130,000 square metres under construction in the Austrian capital this year 117,000 is accounted for by Erste Bank's campus in the Quartier Belvedere, which it will occupy in 2016. Development is now beginning to pick up, with a further 240,000 square metres of new offices due to be completed in the next two years.

Several interviewees also identify potential in the affordable and student housing sectors. Metropolitan Vienna's population is growing rapidly, and the influx of refugees from the Middle East will further stimulate demand for housing.

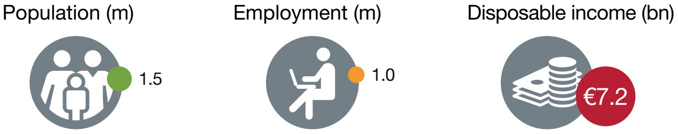
Zurich (2016: 24) (2015: 25)

Investment prospects, 2006-2016



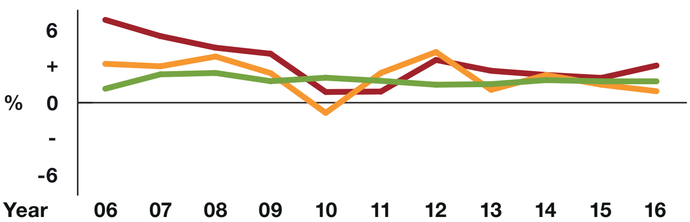
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



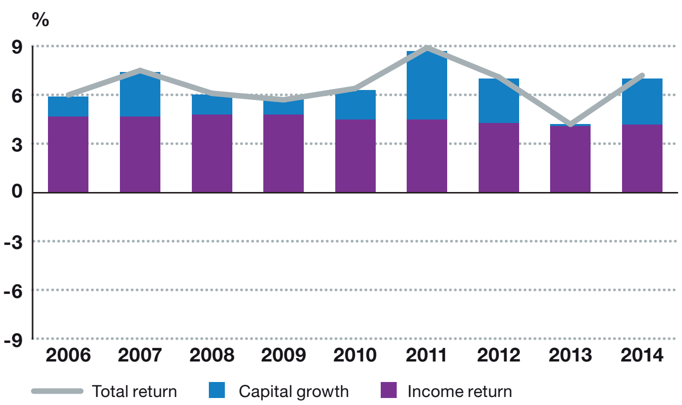
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

"We are generally optimistic but not euphoric," says a local investor.

Zurich's prospects were not helped by the "Swiss franc shock" in early 2015, when the Swiss national bank's decision to un-peg the Swiss franc from the euro floor caused a surge in the value of the local currency.

The move raised fears that the competitiveness of Swiss exports might be compromised, leading to a slowdown in economic growth.

This helps to explain Zurich's continued position in the lower reaches of the table for investment and its 13-place fall to Number 25 in the rankings for development prospects.

In addition, some areas of Zurich are suffering from an oversupply of office space and rents are stable at best. "We see a lot of uncertainty among tenants. Many companies have postponed their growth decisions. There is a broad feeling that something could happen because fundamental issues in Europe have not been solved."

However, the effect of the strong Swiss franc on growth has not been as detrimental as feared, and GDP is expected to increase by 1.1 percent in 2016, according to the OECD.

"Buying assets remains difficult," is a common complaint. "In the Swiss market most of the capital is domestic," says a local. "It is difficult for us to find the right assets, but even more so for foreign investors and when they see the low yields they shy away."

Investment property continues to achieve low yields, sometimes sub-3 percent for prime offices. But the difficulty of acquiring individual buildings is spurring some to focus on renovating their existing ones, or investing in portfolios "because the competition is lower".

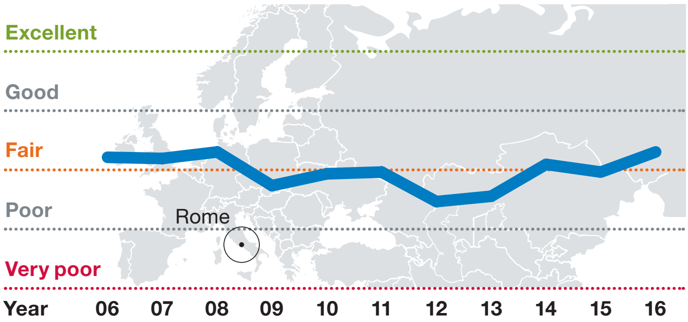
"The demand for offices will further decrease, the demand for residential will stabilise and retail will continue to be in a difficult position, as Switzerland is 'over-retailed'," says a fund manager.

A more optimistic view is that if the Swiss economy strengthens "jobs will certainly be created around Zurich and not elsewhere". The city is strong in medium-sized IT, telecommunications, marketing, PR and technology firms: "those mid-sized companies are the backbone of the Swiss economy."

Continued high pricing of real estate is contingent on maintaining a gap between yields and bond rates, says another local: "Whenever interest rates increase we expect property prices in Switzerland to decrease."

Rome (2016: 25) (2015: 27)

Investment prospects, 2006-2016

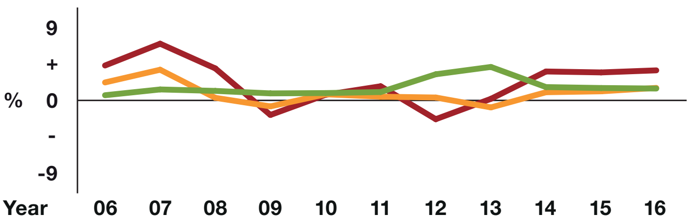


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

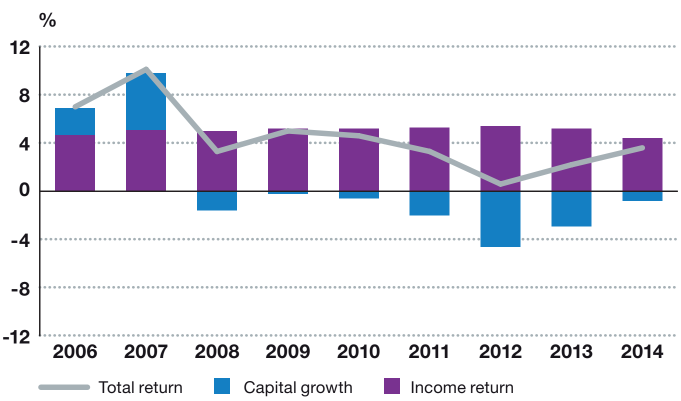
Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014



Source: MSCI

Rome is riding the market's renewed interest in Italy, but compared with Milan, it is the less favoured of the country's two main cities.

"We are not the most transparent market in the world and so the amount of investment is not as great as it could be, but it is certainly increasing and will increase as long as government handles the economic situation correctly."

Alongside lack of transparency, there are other disincentives to investment. "The market in Rome is highly fragmented and dominated by the state," says an investment manager who is planning to exit the market.

While the Italian capital ranks a low Number 25 for investment, its development prospects are judged to have improved significantly with an nine-place leap to Number 18. The reasons for this hike are not immediately obvious, but there have been a number of portfolio purchases that may hold development potential. Several large hotel acquisitions may signal interest in "reconverting" historic buildings to hotels; Rome lacks the level of high-end luxury hotels that Milan has.

Detailed and intimate local knowledge is important: "In Italy, we are seeing value in certain deals and are looking to build relationships with local operating partners, which is key in this jurisdiction."

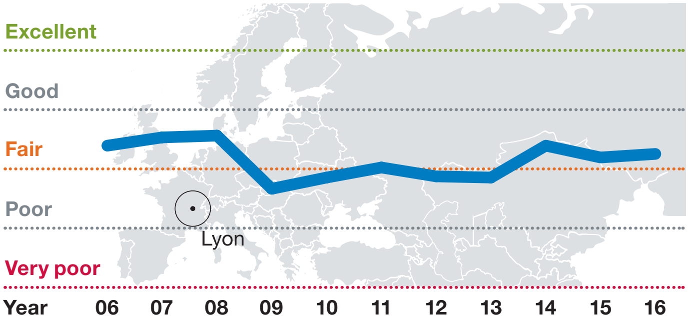
Although Rome and Italy generally have attracted growing interest, opportunities to invest are not abundant: "We look for high-quality stuff – we are not opportunistic. We don't see under-priced product anywhere. Wherever you start selling you will be surprised at the bids you will see."

However, supply could be about to improve as funds reach the end of their life-cycle: "A lot of closed-ended funds were set up in 2005-7 with a 10-year life and a lot of them have run out of road. The equity investors or the debt aren't supporting extensions, so those funds are effectively forced sellers."

Rome could prove more interesting for residential investors. One says: "There is strong demand for renting in Rome."

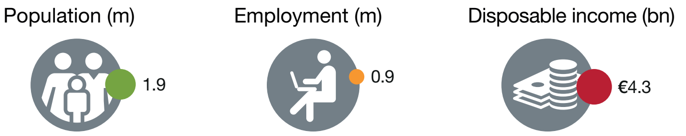
Lyon (2016: 26) (2015: 23)

Investment prospects, 2006-2016



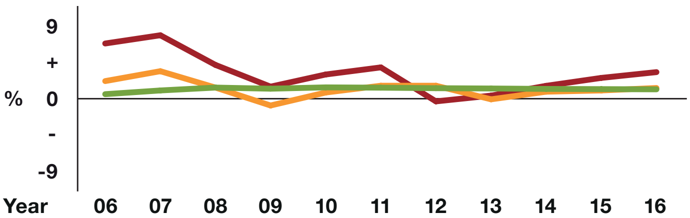
Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016



Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014

MSCI does not produce an index for Lyon.

Lyon is very much a second-tier city, its potential frequently being cited alongside France's other second cities.

While the Paris region commands about 70 percent of investment in France, Lyon takes care of half of what is left. "I think things could get better in Lyon. I feel so-so about Paris. I feel semi-optimistic for Bordeaux," says a French investor. "There is no over-supply and yields are reasonable," notes another.

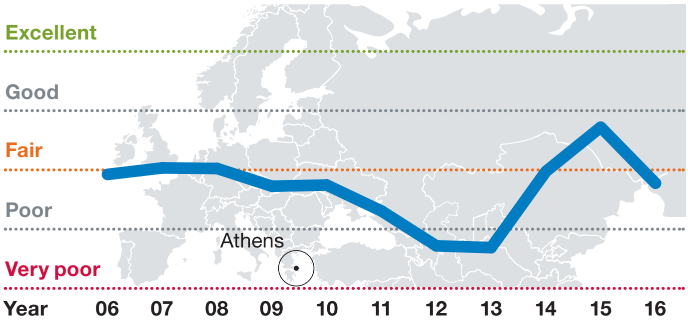
The city has a diverse economy, housing not just industrial groups and life sciences, but a rapidly growing digital sector; it is now considered France's "second Silicon Valley", after Paris.

However, Lyon still languishes towards the bottom of the European league for investment, having slipped three places to Number 26.

Its development prospects are considered brighter, jumping seven places to Number 17. Crédit Agricole's mid-2015 purchase of Grand Hôtel-Dieu de Lyon from developer Eiffage may have been a contributory confidence booster. The 51,500 square metre conversion of a historic building in the centre of the city includes retail, offices and a conference centre as well as a 143-room hotel, which will house InterContinental's fifth hotel in France when the project completes in 2018.

Athens (2016: 27) (2015: 5)

Investment prospects, 2006-2016

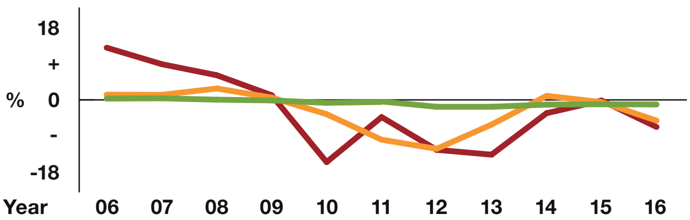


Source: *Emerging Trends Europe* survey 2016

Total population, employment and disposable income, 2016

Source: Moody's Analytics

Population, employment and disposable income, annual change 2006–2016



Source: Moody's Analytics

All-property return, 2006-2014

MSCI does not produce an index for Athens.

The optimism that saw Athens surge to Number 5 in 2015 has evaporated entirely after a year of political and economic chaos in which an exit from the euro was only prevented by frantic last-minute negotiations.

An international investor says: "In this survey last year we were surprised by the number of people saying that Greece is the hot place to go and look. We didn't think that then and we don't think that now."

The Greek capital's new ranking at Number 27 and its "very poor" rating for development prospects reflect the gravity of the country's economic predicament.

Many interviewees fear that the crisis is far from over: "Greece would still be hitting the headlines if it wasn't for immigration and Syria and everything else," says one.

There is also more pain ahead for the Greek economy. The austerity programme that Greece agreed with its creditors will shrink the economy at the same time as taxes are increasing in an attempt to balance the books. Consumer spending will suffer. Business confidence is at rock bottom.

Foreign property investors might find bargains, and "there is still a handful of investors looking at Greece although not with the same intensity as 12 months ago". "By the end of 2016, Greece could become interesting," says one fund manager.

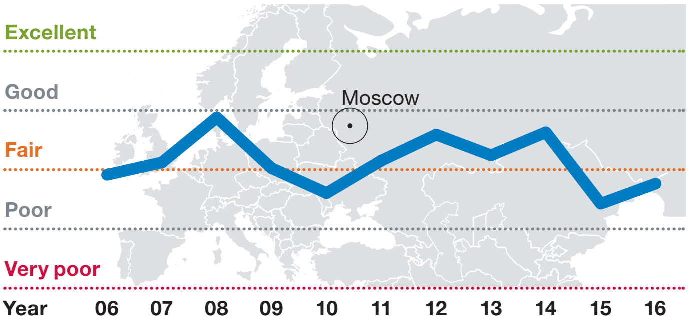
However, only forced sellers are likely to dispose of assets in a market in which values have fallen by 60-85 percent depending on asset type since 2007, according to one local.

Meanwhile, the imposition of capital controls means that investors will find it difficult to get their money out of the country.

"What is happening here is extreme," says a Greek interviewee. "The collapse is so big and has lasted so long that it has totally disorganised the property sector."

Moscow (2016: 28) (2015: 28)

Investment prospects, 2006-2016



Source: *Emerging Trends Europe* survey 2016

Population, employment and disposable income

Moody's Analytics does not currently provide these figures.

All-property return, 2006-2014

MSCI does not produce an index for Moscow.

One positive observation about Moscow's situation: it can only get better. "It's stable at the bottom."

"We expect a slight improvement in the overall business environment in the next 12 months because it is so bad at the moment and we are starting from a low base. I believe we are more or less at the bottom of the cycle."

But there are more sanguine views: "Prospects for 2016 are reasonably good. It does depend on how external factors such as oil and the exchange rate affect us. But the things that are under our control, we have a good handle on," says a local.

The overwhelming view is that Moscow is now cut off from global capital. "Moscow is out. Unknown, unloved." However, some hope "the gap will be filled by Asian investors"; there is still domestic capital, some of which is being repatriated from abroad: "Russia is full of money."

Russia and Moscow may currently be a no-go for most foreign players, but locals are hunkered down and taking a measured view. "We have experience how to survive through a crisis," says one who is "moderately pessimistic".

Logistics is tipped by several: "Sanctions have started a trend towards import substitution, and some international companies have localised production."

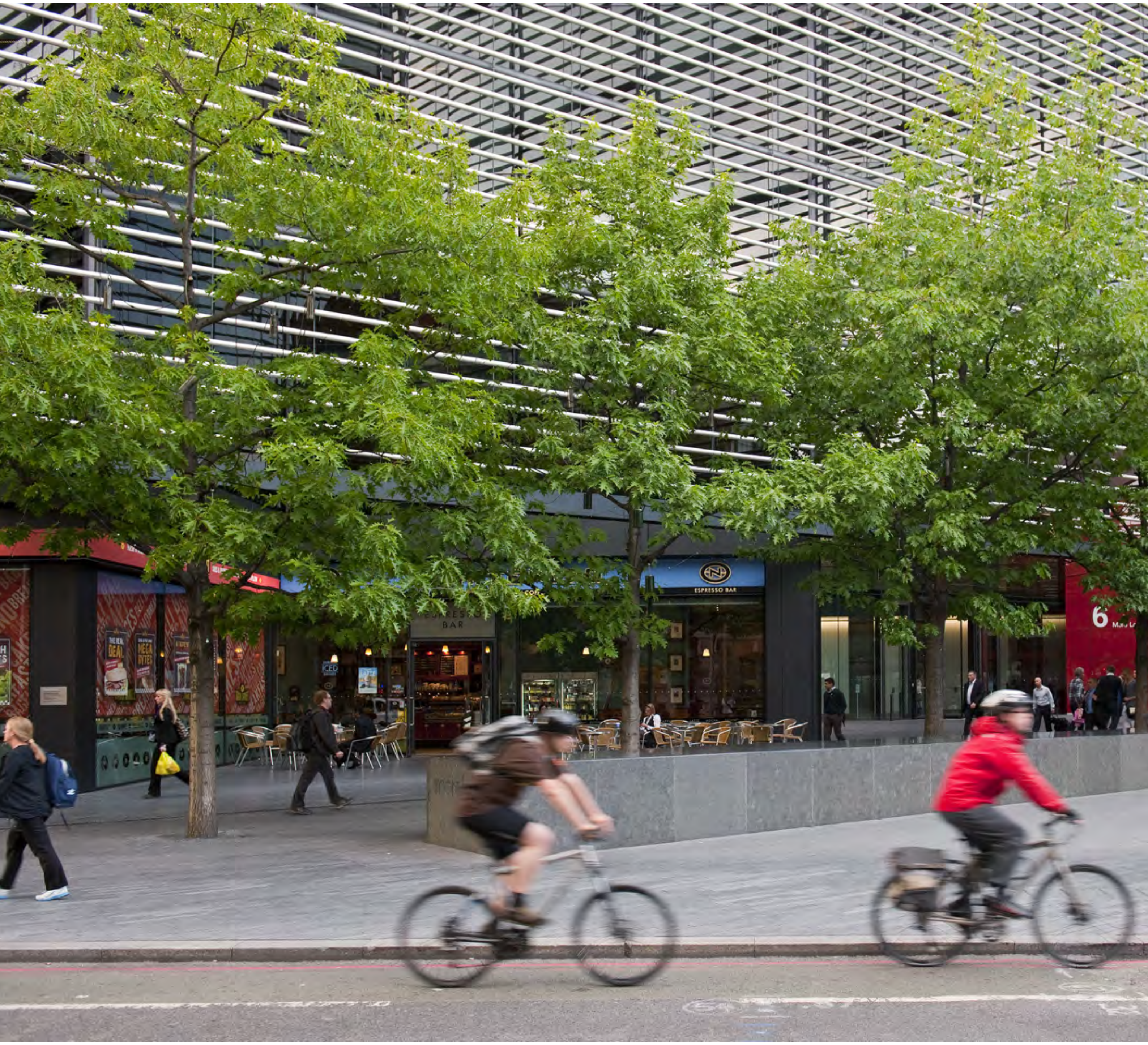
Moscow's office yields have been pushed out to 12 percent and interviewees say they are heading for 13-14 percent. A significant change has been the "roublization" of the market. Whereas rents and capital values used to be quoted in US dollars for properties with international potential, there has now been a switch to local currency.

"In dollar terms there has been significant repricing of assets. But in local currency terms, cash-flow is fairly stable."

Locals say there will now be greater differentiation between good and poorer property. "The market was never oversupplied for any length of time, so prices of poor quality assets have been unreasonably high. Now there is a lot of re-pricing in a move to fair pricing as opposed to over-excitement because of that lack of supply."

Chapter 4

Changing places



For the most innovative, forward-looking businesses in real estate, the concept of landlord and tenant is fast becoming outdated: tenants are now consumers of real estate.

"Twenty years ago we had tenants, now we have customers. In 20 years' time we will have guests."

"Twenty years ago we had tenants, now we have customers. In 20 years' time we will have guests," predicts the CEO of a major European REIT. "We have to evolve the business model to suit the changing world."

This evolution is being helped by rapid technological advances that are providing occupiers with the tools to value property in new and more complex ways.

"With just a few metrics, occupiers can now understand whether space is being used, wasted and whether it is a healthy place to be."

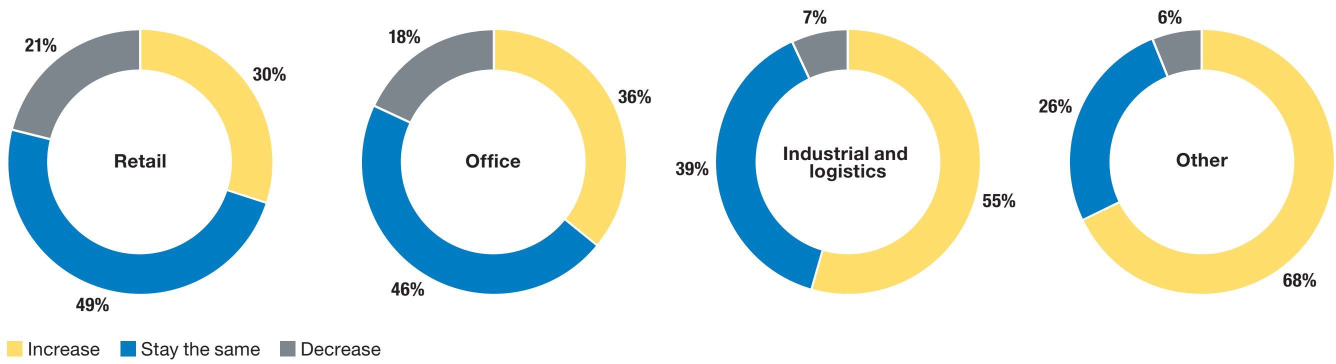
The role of buildings is changing and increasingly linked to productivity – the occupiers' ability to perform. "There is an increasing realisation that there is value to the way a building is run rather than what rent is paid and what covenant it has."

Businesses recognise that a thoughtful, progressive work environment can reflect brand value, while improving health and productivity, innovation and collaboration in a workforce.

Moreover, mobile working and e-tailing are not the unmitigated threat they once appeared. Online retailers are craving a physical presence to promote their brands; shoppers are using smartphones to research products that they will purchase in-store; demand for click and collect in-store is rising. There are even flickers of hope for the high street, as brands that previously operated through concessions lease their own stores for the first time.

Logistics firms are similarly positive. Online retailers are demanding three times more warehouse space than traditional ones. And as fast-expanding e-commerce firms develop smarter strategies to distribute goods, they're requiring a diverse range of facilities.

Figure 4-1 **Change expected in occupiers' space requirements, 2016**



Source: *Emerging Trends Europe* survey 2016

How buildings are used is now more important than the asset itself

This change is not all good for property owners, nor easy for them to accept. With apps, office users can see that they need fewer square metres, or that the air quality or light they work with is poor. Sophisticated booking-in technology has boosted staff-to-desk ratios, decreasing space requirements.

"Occupiers used to crush people into a building and not spend any money on it during the lease. Now, the building says something about your business. It is part of value creation, helping to recruit, enforce the brand and provide visible sustainability credentials that you can talk about."

One European developer insists: "We major on persuading people they need to move into a new office, focusing on staff wellbeing, flexibility, efficiency and power resilience."

Yet many in the industry still fall short of the most progressive trends and are reluctant to embrace the idea of the real estate customer, according to some of *Emerging Trends Europe*'s interviewees. "Landlords are not getting their head around what occupiers need," says one. Another complains: "Most developers insist on a formula that's worked before. They are stuck in a rut."

The interviews point to an industry that is grappling to come to terms with the impact of occupier-led, disruptive forces on the traditional real estate model. Respondents have polarised views on optimal lease lengths, the credibility of the ultra-flexible, shared/serviced office model, changing operational skill requirements for property managers, and how all of the above should alter traditional property valuation methodologies and covenant strength.

Back to the city

Some occupier needs will always be fundamental to real estate. "It's all about location, location, location … and location again," says the CEO of a private equity firm.

Not so long ago, some occupiers were questioning the wisdom of remaining in expensive city centres, especially with big, back office operations.

This year *Emerging Trends Europe* posed specific questions about occupational demand, and the response underlines the increasing importance of urbanisation to decision-making in the industry.

Today, time-starved, dual-income families and car-averse millennials are less tolerant of longer commutes. This is part of the broader dynamic that is shaping where the most desirable places to work and live are, and that is cities.

There is a clear move by people towards "sharing utilities and experiences in the centre of cities rather than owning my little piece of green garden in the suburbs".

One pan-European developer observes: "The typical worker no longer wants to do the commute. They want to work, sleep and eat in the same place. As a developer, we are creating new types of shopping and residential ... residential units are getting smaller and design is changing."

As one Nordic developer puts it: "Multi-use, integrated projects are in – office, residential, public healthcare, public services and retail, with everything connected as a kind of small city-within-a-city."

Urbanisation is breathing new life into traditional office locations, not in a retro way, but as centres of business innovation.

A new breed of office landlord has emerged from this movement back into cities, providing temporary spaces for companies large and small – all of them craving flexibility from their working environments. "The growth of the serviced office market is only limited by the number of workers. There are 1 billion mobile workers on the planet because of fast-speed telecoms."

The recession has made occupiers shy away from long-term, capital-intensive commitments like a 20-year lease. They are also attracted by the exposure flexible space gives them to a range of interesting businesses. Sharing facilities – such as event space or fitness centres – also enables occupiers to get more for their money.

"The sector could grow many times from the size of what it is today over the next 10 years. There is increased adoption of flexible space for larger companies and that will drive a lot of growth."

The likes of Google, Apple and Yell have signed up to membership schemes that offer networks of serviced offices. And space providers like Regus are expanding into high footfall locations: railway stations, motorway service stations, airports, shopping centres and hotels.

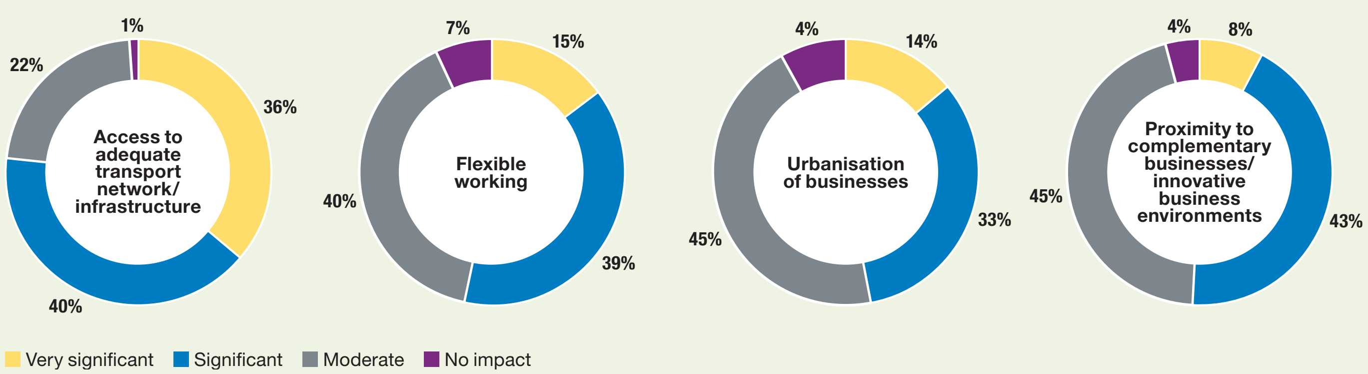
"You pay more per square foot for less space but you have a much richer experience as you have shared facilities at your disposal. There's a real financial logic that is driving this."

What is more, landlords offering short-term flexibility say they retain tenants long-term. As one concludes: "We've been going for 12 years and we have clients that have been with us all that time. They grow with us and move to different buildings. The average length of stay is 36 months."

As one investor concludes: "Megatrends are about changing business practice and urban density is changing how real estate is used."

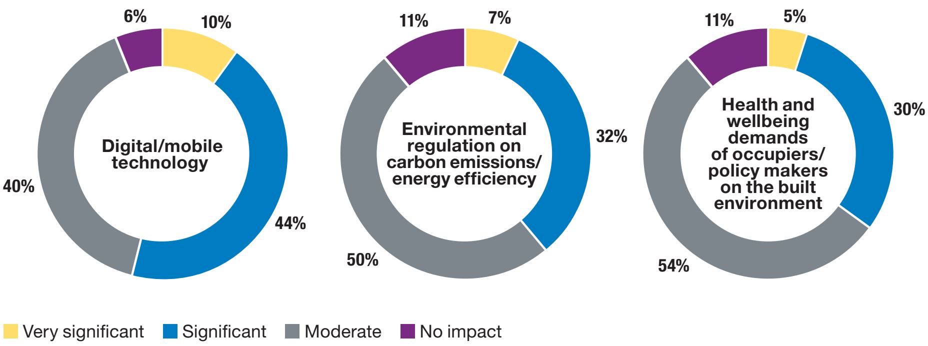
"You pay more per square foot for less space but you have a much richer experience. There is a real financial logic driving this."

Figure 4-2 **Impact on occupiers' space requirements over the next 3-5 years**



Source: *Emerging Trends Europe* survey 2016

Figure 4-3 **Impact on building obsolescence over the next 3-5 years**



Source: *Emerging Trends Europe* survey 2016

New age offices

The technology, media and telecommunications (TMT) sector attracts press coverage for whacky fit-outs, invariably catering to the millennials among its employees, but wholesale, long-term changes are emerging from a range of other occupiers.

Both the tech businesses and the millennials are important in the sense that they are leading what is arguably a broader, cross-generational social, cultural and demographic change towards a more informed and demanding occupier. From new graduates up to middle management, faced with working for longer periods of their lives, they are all becoming more demanding about making sure their working life is in harmony with their lifestyle needs.

Businesses must respond to these changes to attract and retain top talent – providing childcare, flexible working, job shares, healthcare plans, and paying attention to how their corporate brand is in tune with that of their employees.

This clearly has implications for property developers, operators and investors, who need to understand the role the physical workplace can play in talent management and workplace productivity. *Emerging Trends Europe*'s interviewees and survey respondents see this as an opportunity and a threat – a threat because buildings will become structurally obsolete or not fitted-out, managed and operated effectively, when assessed against these new occupier demands.

Businesses such as Shell are requiring highly technical environments that also foster teamwork, making project development quicker and more efficient; leading-edge video conferencing facilities help the firm connect to offices globally.

Banks are focused on buildings that promote a more open culture and collaboration. Some occupiers might want an open-plan environment, while others are seeking to create more intimate spaces to foster a sense of belonging.

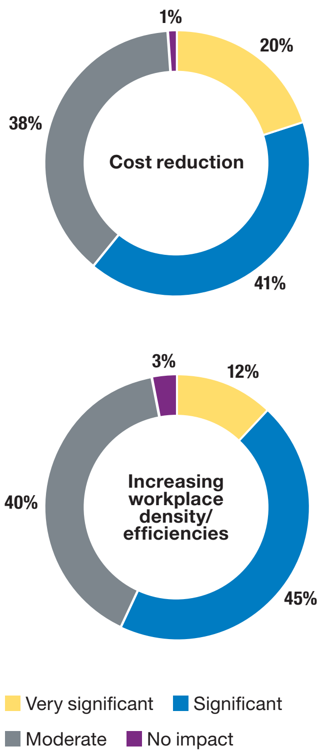
There are clearly no cookie-cutter solutions. “What is done in an office has to be relevant; it isn’t just about having a tennis table for the sake of it.”

As one interviewee suggests: “There’s enduring value of place in a placeless world. As we become more digitalised, the office is a company’s one shot at manifesting the culture of an organisation. Offices are more important today because employees need a sense of belonging.”

And landlords are designing buildings with: wifi-enabled cafes that turn into a members’ bar at night, roof gardens, fitness centres that offer classes with 24-hour access, cinema and event spaces, and cycle storage, plus offering spaces like phone booths for private meetings and different types of workstations. Meeting rooms are equipped with different furniture and light fittings so they do not appear too uniform. But most significantly, buildings also need to be located near excellent public transport links.

Appealing to such occupiers may require giving up revenue. One landlord put kitchens on every floor and made corridors wider than regulations dictated to give people more sense of space. “You have to be generous with space and in non-income producing areas. If you’re not greedy then it can go a long way to creating demand for your product. We are currently 99 percent occupied across a portfolio of 900,000 square feet.”

Figure 4-4 **Impact on occupiers' space requirements over the next 3-5 years**



Source: *Emerging Trends Europe* survey 2016

Space for staff shrinks

Businesses are seeking to work real estate more intensively. "Every company has to be more efficient because space is more expensive."

"A lot of the time we're designing meeting rooms out of schemes because they're only fit for one use." Meeting room "pods" on wheels or temporary screens that create pop-up rooms as needed reduce square footage.

From Jaguar Land Rover to N Power and Virgin, major companies are looking at how they can get away without desks. "The need to give all staff set spaces from 9 to 5 is a thing of the past."

Greater people-to-desk ratios are supported with sophisticated booking-in systems that allow workers to claim space for an hour, half day or weeks. "The idea of measuring productivity by the number of hours spent at a desk is outdated."

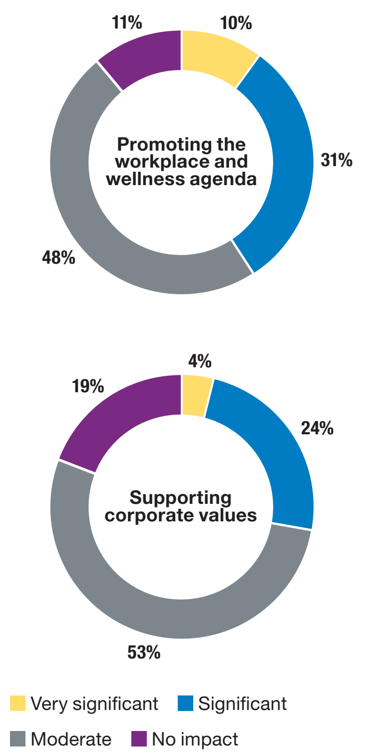
Says a major corporate's head of real estate: "We have come down from 120 square feet per person to 80 square feet and we think we can drive that lower." This is being achieved by providing staff with the opportunity and tools to work remotely.

"That means an awful lot of corporations will be using less space but using it more intensively."

When Italian bank UniCredit moved 4,000 staff to its new HQ in Milan, it consolidated from 26 to five offices in the city, reducing its portfolio by 55,000 square metres and saving €25 million on property costs a year.

Common areas, such as meeting rooms, account for a third of the new space with a near-total elimination of single-occupancy offices. The strategy is being rolled out across Europe: UniCredit Bank Austria Town in Vienna will accommodate 3,000 staff in a single room.

Figure 4-5 **Impact on occupiers' space requirements over the next 3-5 years**



Source: *Emerging Trends Europe* survey 2016

New apps are supporting savvy real estate strategies. Electronic passes and locking systems track what rooms are occupied; booking-in software shows which desks are being used, while GPS tracks circulation and usage of building space. "One of our clients was looking at taking 9,000 square feet of expansion space and in the meantime found around 120 desks they had in their current building weren't being used."

Emerging Trends Europe's survey findings suggest that the real estate industry tends to look at changing patterns of space requirements among its customers through a narrow prism of efficiency gains.

But occupiers are saying they want buildings that promote inclusiveness and collaboration, which also support business success. Over two-thirds of organisations covered by CBRE in its *European Occupier 2015 Survey* see attracting and retaining employees as the main driver of their workplace strategies, and 46 percent, increasing productivity. In another recent study, RealService found that less than one in three occupiers in the UK thinks the real estate industry understands their business needs.

"Some of the great corporate failures have been to do with separation of function, with people sat in cellular spaces that didn't allow anyone to communicate with one another."

Healthy buildings, happy staff

Occupiers will increasingly base real estate decisions on how healthy a building is for their staff. "It is about designing real estate strategies around the human factor." To that end, for example, British Land, the UK's largest REIT, has appointed a dedicated wellbeing expert.

This focus on wellbeing is seen as an evolution of the sustainability agenda, particularly relevant in the office and logistics sectors: "It is cheaper to provide healthier environments than environments that are certifiably sustainable."

While occupiers once saw expensive solar panels and rain harvesting systems as key to their green credentials, they are now interested in natural light levels, adopting natural materials, natural ventilation and how layouts impact worker mobility.

"We are a big believer in wellness," says one occupier. "If you create a very green building you also need to create a building that is good for the human being."

The health and wellbeing movement has the potential to develop more quickly and have more direct impact on owners and operators of offices than the traditional environmental factors. "Sustainability has always seemed like quite a remote concept, but our health is personal and immediate, it affects you, me and our families right now," comments one interviewee.

New technology enables occupiers to monitor their environments more easily and cheaply, and the availability of data enables stronger links to productivity. "Air quality mapping can now be done on a smartphone."

Retail – online and offline

Online shopping is maturing in unexpected ways. Consumers now want a seamless physical and digital shopping experience from a brand, and this is challenging retailers and landlords to make the link between online and offline more sophisticated.

Customer feedback says online retailers should have a presence on high streets so they can see products on offer, and have access to better customer service.

Thus, e-commerce trader Harmony inaugurated its first store in Paris recently. And online catalogue retailer Boden is now looking to open stores across London, even though its website drives 90 percent of sales.

Other retailers that have only operated through wholesalers before are now searching for space, wanting better control over product presentation and brand identity. "Six years ago all of our brands were sold mainly through wholesale retailers. Our exposure to physical retail has gone from 30 percent then to 65 percent today."

Shoppers are using the internet as a "shop window" to research products, but then go to a store to buy goods. Some retailers report that in consequence, visits are fewer, but longer and involve greater spends.

For their part, retailers are seeking to boost click and collect in-store to reduce costs. Home delivery requires more logistics, while a click and collect order can be fulfilled by adding it to lorry loads already heading for the store.

"Smart retailers are working with owners to adapt spaces to be as consumer-friendly as possible. This is an exciting time for landlords," says one interviewee. "The fundamental point is that we are trying to drive customer satisfaction with whatever we do. It is not just about apps, it is not just about advertising, or new store formats or providing more catering in shopping centres, it is about all of it."

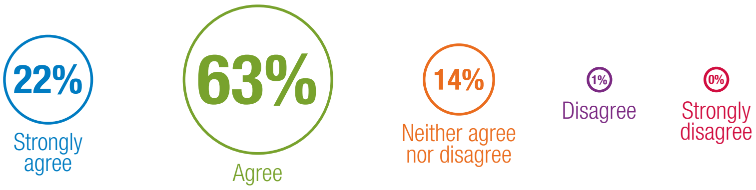
So some property businesses are clearly responding. "We are making changes to centres such as introducing a centralised click and collect service, having parking payment schemes that acknowledge that some people may only be there to click and collect, and introducing wifi. However different retailers have different views on this – some want their own in-store wifi, or their own click and collect service."

Luxury retailers still favour bricks-and-mortar as their primary route to market in favoured locations such as Paris, Milan and London. But they too are using technology to enhance experiences in-store, where people can view products, news and trends.

For these brands, their online capabilities provide additional tools to offer exceptional customer care. One brand, for instance, uses video conferencing for their customers to contact specialist staff post-purchase.

Innovative property owners see potential in the need for retailers to provide a sophisticated shopping experience both on and offline. Intu, which owns centres in Spain and the UK, has spearheaded an affiliate website to support its retail tenants' omni-channel strategies. Developed by an in-house digital team, intu.co.uk has 300 retailers signed up and received 22 million visitors in the first year after launch.

Technology is changing the way we use buildings



Data-driven decisions

Technology is also aiding location decisions. Using customer data, online retailers can be savvy about where to take space. "They have millions of customers and can tag where their hotspots are."

Landlords are turning data to their advantage, too. Digital marketing through smartphones, website visits, emails, and social media are an increasingly crucial part of drawing footfall. Apps guide the customers' journey through the shopping centre, help them to park their cars, find friends, book restaurants, view special offers and access click and collect services.

Landlords can also see how footfall moves from store to store, providing information about how the tenant mix is working. This helps improve revenue for occupiers and owners alike.

But there is a question of how far the property sector wants to go. "We are not an innovator of technology – as this is too risky. We are happy to be just behind the cutting edge of technology," says the director of a large European property company.

Shopping for lifestyles

"We are just at the beginning of trying to change shopping centres to lifestyle environments."

Landlords are investing more in analysing shoppers to identify trends and understand what they want from the physical retail experience. "Understanding human behaviour will be important in our business," says a Belgian property owner.

More excitement, entertainment and store fronts which are refreshed several times a year are high on the list of customer expectations today, as well as personalised information on mobiles.

The formula is simpler than landlords may have first feared. "Today we can attract people because they are hungry, thirsty, they want to see a movie, or shop."

"The importance of catering and leisure has gone off the scale. It now accounts for a third of the space in some centres. It extends dwell times. A tenant will complain if the landlord doesn't do a proper job of the experiential stuff."

Retailers are up on this trend, too. Some now provide customers with food and drink in-store, creating a unique shopping experience. Fashion label Replay has a restaurant-cum-bar in its "multi-experience store" in Milan's Porta Nuova; it will also feature art exhibitions.

And at its Mall of Scandinavia in Stockholm, Unibail Rodamco is piloting a Designer Gallery, bringing occupiers that would not normally lease space in a mall, to keep its offering fresh. It includes pop-ups, plus a rotating programme of events and art installations.

Retailers also want units that give them scope to "maintain the wow factor": space to showcase several trends at once, provide different shops-in-shops and style studios.

Their desire to create unique experiences and brand promotion has also led to leasing unusual spaces and a focus on heritage buildings. Amsterdam's Canal Belt district has attracted both well-established and upcoming brands to its nine streets of 17th-century buildings. Marketed as De 9 Straatjes, it is fast gaining a reputation as Amsterdam's best shopping hub. And American shoe brand Vans has taken space in the railway arches under London's Waterloo station for an indoor skate park, live music venue and gallery.

Interviewees also predict occupiers will seek to use bricks-and-mortar for exterior branding. "We have more retailers asking for signage on buildings. This is very typical in Hong Kong, for instance, where the skyline is plastered with a number of brand advertisements. This has created a revenue opportunity for us. That's valuable real estate, it is a commercial opportunity."

Occupiers are willing to pay for shorter leases and enhanced flexibility

Leasing lags omni-channel retailing

While retailers and landlords are co-operating more in tackling the challenges they face from online shopping, translating this into leasing agreements remains less established.

Landlords say that tenants are still failing to acknowledge that their overall sales growth is the result of complex interplays between physical and virtual.

"We have tenants who tell us in-store sales are down but then we see their overall profitability is up. They come to us and say 'what are you going to do' and we say 'nothing'. They price physical stores as a cost and remove profit from them to a different part of the balance sheet. We say the value of the space hasn't changed."

Another issue is lease lengths. Occupiers are increasingly asking for five-year breaks, as they seek flexibility to adapt to a fast-changing world. "That goes below a level of comfort for us and so we have to make rent more expensive. But retailers aren't able to predict how much their businesses will change. Everyone's trying to figure out how that plays into real estate strategies."

And, as customers demand more dynamism from their retail environments, time between refurbishments is compressing. A new fit-out every two to three years is now the norm, from every five to seven historically.

One retailer argues that increased investment on fit-outs makes longer leases more, not less, appropriate. "Fit-outs are expensive. You can amortise that over 10 years, but over a three-year period it is harder. If you've spent a lot of capital on your store you want to keep that location."

> "Fit-outs are expensive. If you've spent a lot of capital on your store you want to keep that location."

Logistics keeps delivering

With global e-commerce sales growing 20 percent annually, major transformations are looming for logistics, with third-party providers increasingly seeking service points, processing centres and warehouse space.

These operators are investing in bricks and mortar to keep up with fast-changing consumer habits. Rather than traditional warehouses servicing stores, they demand a diverse range of properties suitable for delivering products direct to the customer.

E-commerce businesses are adapting traditional logistics facilities rather than seeking expensive modern buildings; they look for high-quality space in superior locations with higher ceiling heights. "Many are in buildings that are 10 years old or more."

They want space near large metropolitan areas to deliver goods speedily and are storing more inventory in stores close to large towns and cities to fulfil online orders more quickly. Online retailers are also requiring larger buildings to handle a wide variety of goods.

Tough new world

Across all sectors, the challenge is for the real estate industry to be more service-orientated and enhance “the customer experience”. Technology is giving occupiers a greater voice. “Things are changing. We had a two-hour meeting with our IT department today to discuss our five-year strategy for real estate.”

However, few in real estate are really embracing these trends. “We are working with an occupier which wants to do something sensational with its new office space but the developer will not be flexible because they want a standard design they see as being able to preserve value long term. My argument is the way trends are going, tenants want openness and flexibility in a building and that is where values are.”

And it’s a tough new world in which to play, with the twin challenge being to anticipate the long-term needs of tenants and ensure they see the value in what is being offered.

Some argue that while “landlords are in tune with the needs of occupiers”, other sections of the industry remain behind the times: “Asset managers are a long way behind. They never come out from behind a desk and are inflexible to occupier feedback about a building. They need to realise life is changing and people need far more engagement than before.”

There at least seems to be broad recognition that the industry needs to keep on its toes. “Data is changing the world fast and real estate is only just getting its head around it.”

As the Urban Land Institute's *Innovation Report* advocates,“real estate needs to revolutionise its modus operandi and adopt a ‘service provider’ mindset if it is to effectively service and profit from the innovation economy”.

Some predict the more sophisticated property management used by residential operators could trickle across to other real estate classes. “Staff are incentivised around quality of service and satisfaction levels. It is an interesting trend and the property industry is just getting to grips with this.”

But as one interviewee warns: “Lack of alignment between how owners, managers and occupiers see a well-performing building is an issue. There needs to be a new language around this. Performance needs to be defined as something that supports occupiers’ differing aims. Landlords need to support the value creation side of their tenants’ businesses.”

“Lack of alignment between how owners, managers and occupiers see a well-performing building is an issue.”

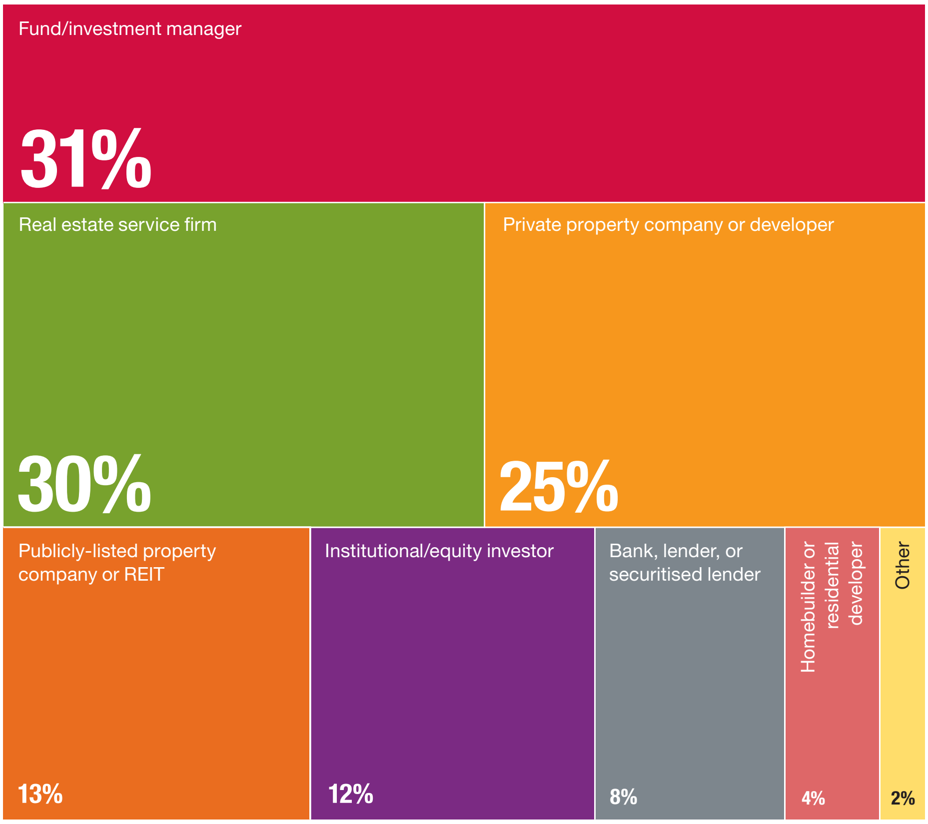
About the survey

Emerging Trends in Real Estate® Europe, a trends and forecast publication now in its 13th 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 2016 reflects the views of over 550 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.

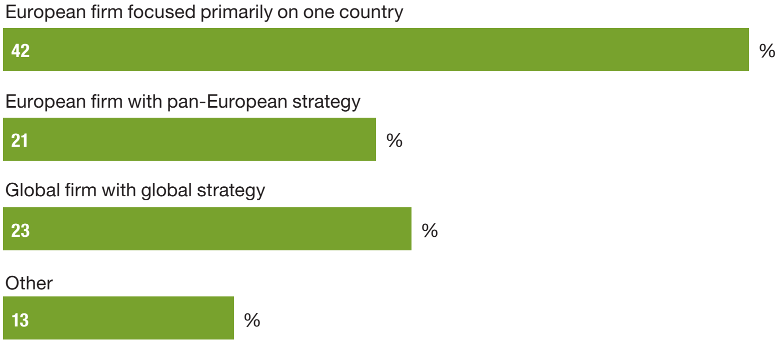
A list of the interview participants in this year's study appears on the following pages. To all who helped, ULI and PwC extend sincere thanks for sharing valuable time and expertise. Without their involvement, this report would not have been possible.

Survey results



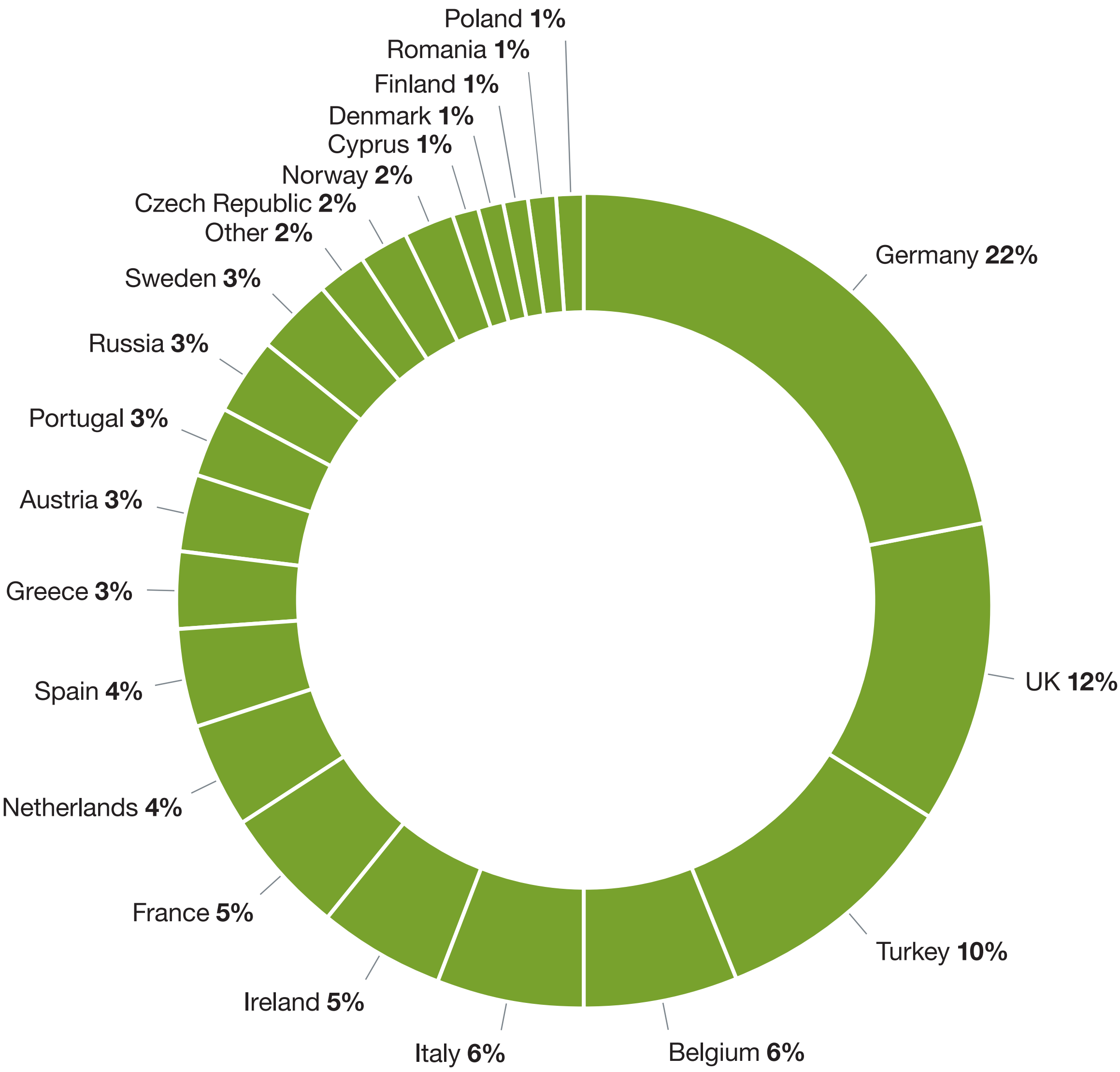
Source: *Emerging Trends Europe* survey 2016
Note: Respondents could choose more than one category, so percentages do not add up to 100.

Survey responses by geographic scope of firm



Source: *Emerging Trends Europe* survey 2016
Note: Respondents could choose more than one category, so percentages do not add up to 100.

Survey responses by country



Source: *Emerging Trends Europe* survey 2016

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- Exploring issues of urbanization, conservation, regeneration, land use, capital formation, and sustainable development;
- Advancing land use policies and design practices that respect the uniqueness of both built and natural environments;
- Sharing knowledge through education, applied research, publishing, and electronic media; and
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Emerging Trends in Real Estate® Europe 2016

Emerging Trends in Real Estate®

Europe 2016

What are the best bets for investment and development across Europe in 2016? Based on personal interviews with and surveys from over 550 of the most influential leaders in the real estate industry, this forecast will give you the heads-up on where to invest, what to develop, which markets and sectors offer the best prospects, and trends in capital flows that will affect real estate. A joint undertaking of PwC and the Urban Land Institute, this 13th edition of *Emerging Trends Europe* is the forecast you can count on for no-nonsense, expert insight.

Highlights

- Tells you what to expect and where the best opportunities are.
- Elaborates on trends in the capital markets, including sources and flows of equity and debt capital.
- Reports on how the economy and concerns about credit issues are affecting real estate.
- Discusses which European cities and property sectors offer the most and least potential.
- Describes the impact of social and political trends on real estate.

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