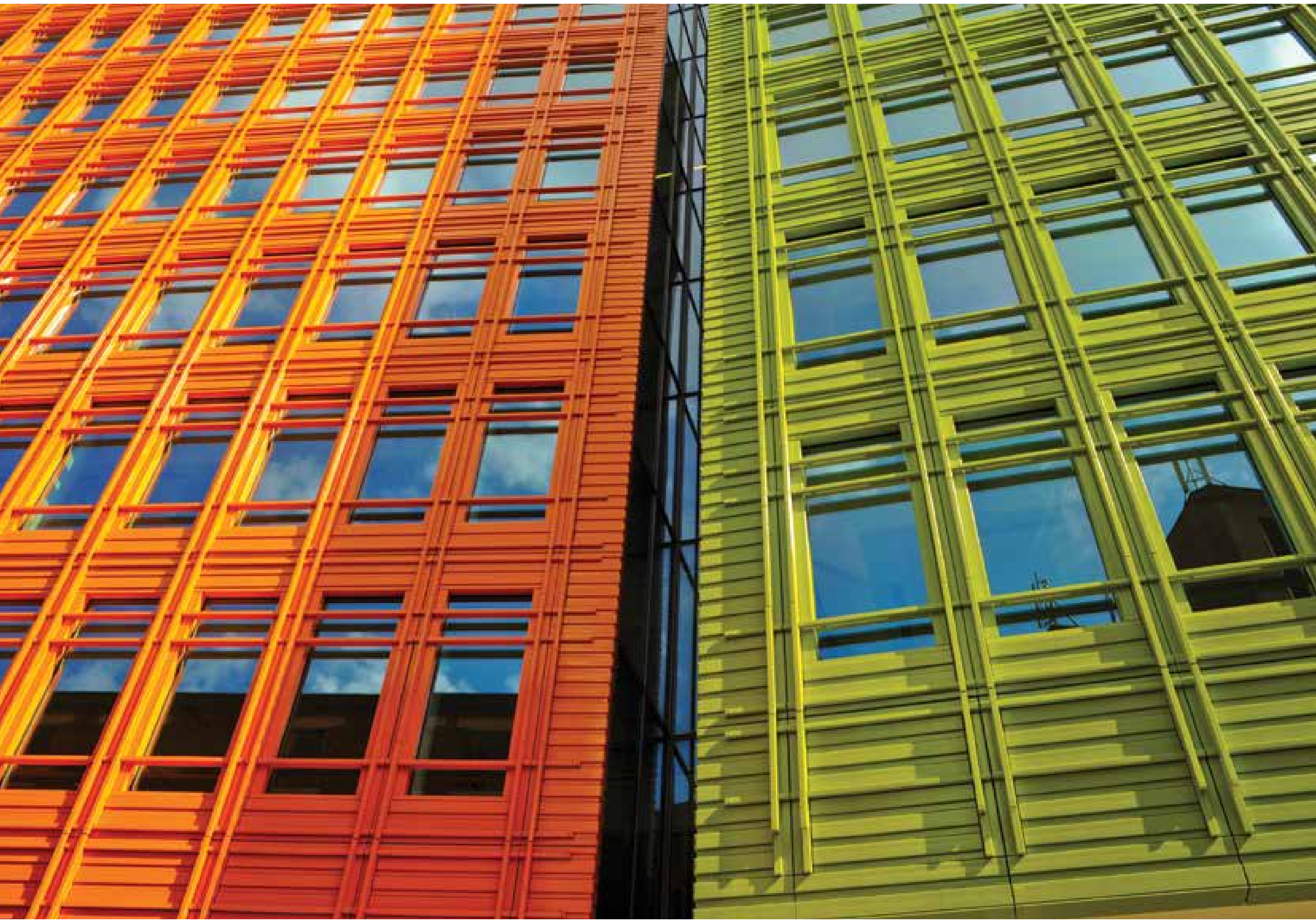


Emerging Trends in Real Estate®

Real estate returns

Europe 2014

Contents

Business environment

Confidence has returned to real estate markets and Europe is once again the place to do business.

Allocations to real estate are increasing and investment activity is gathering momentum in core markets. But just as importantly, there are clear signs it is spreading to regional cities. And increasingly, development is seen as a viable option for investors.

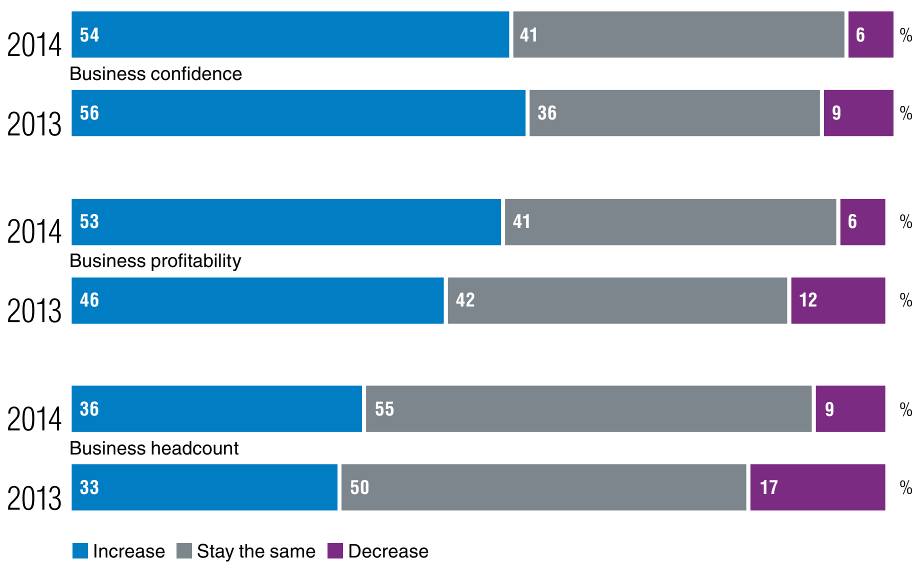
Emerging Trends Europe's survey reflects an improving business environment and the prospect of higher profitability and headcount for 2014, with only isolated pockets of gloom (see Figure 1).

Half of those surveyed expect to better their profits in 2014, and very few – 6 percent – expect to do worse. The most bullish about their business in 2014 are respondents in Ireland, Central & Eastern Europe, and the UK, while fewer of those in Southern Europe – Spain, Italy, Portugal and Greece – are expecting profits to grow (see Figure 2). Benelux and Switzerland are also more downbeat.

But concerns over political uncertainty and a potential dismantling of the eurozone – such a corrosive backdrop to previous surveys – have eased, at least for the time being (see Figure 3) and more than half the respondents believe Europe's economy will improve.

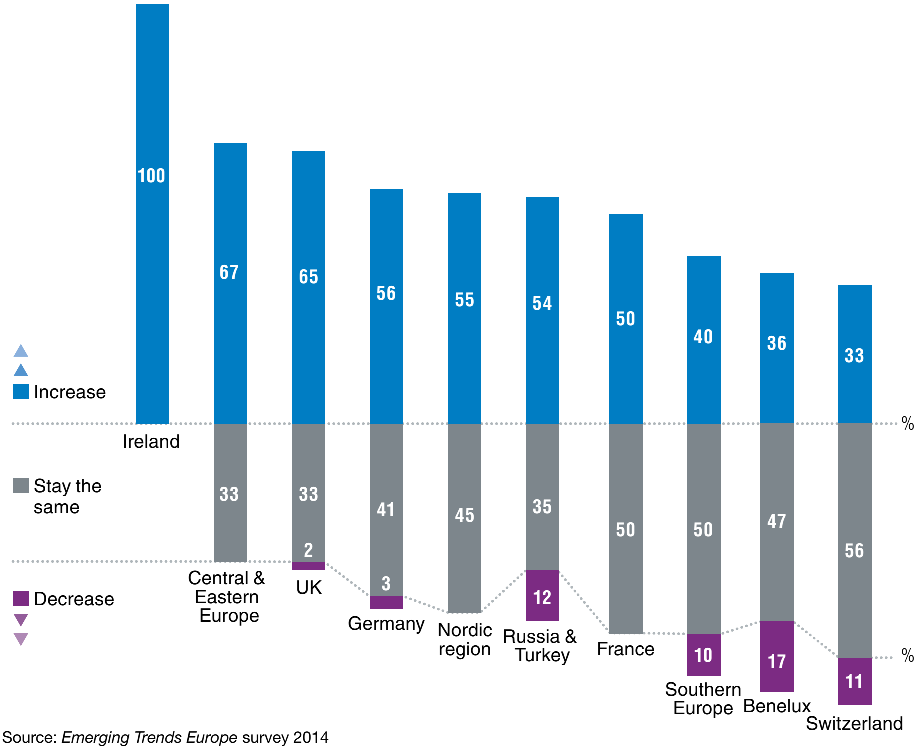
53%
expect to better their profits in 2014.

Figure 1 **Business prospects in 2014**



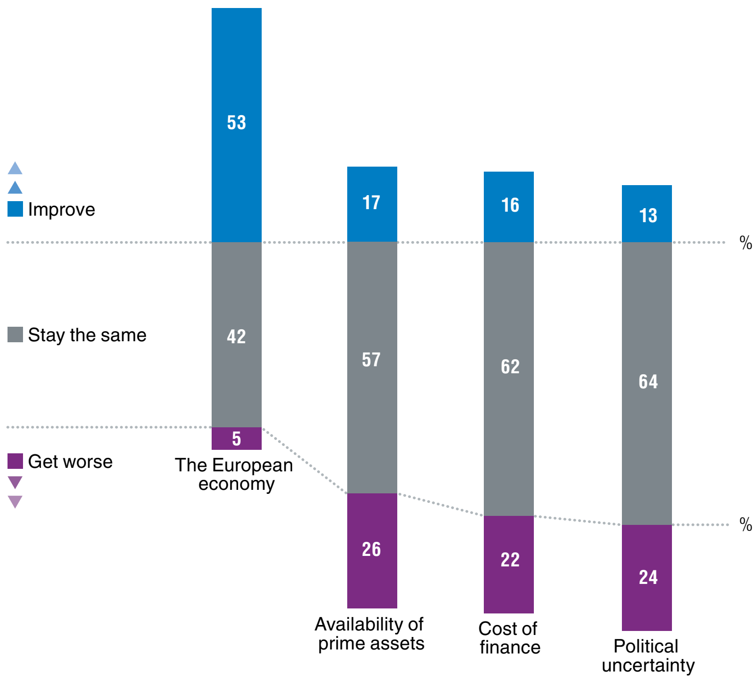
Note: Percentages may not total 100 due to rounding.
Source: *Emerging Trends Europe* survey 2014

Figure 2 **Business profitability in 2014**



Source: *Emerging Trends Europe* survey 2014

Figure 3 **European business environment in 2014**



Source: *Emerging Trends Europe* survey 2014

They suggest that the recovery, though gradual and fragile, will carry with it some rental growth, which has been the missing ingredient in the investment mix. "The only way the capital markets side can be sustained is if it is moving together with occupier demand," says one interviewee.

However, the cost of finance remains an issue for many respondents (see Figure 4). Short- and long-term market rates are expected to rise in 2014, although there is a widespread belief that political leaders and central banks will keep base rates at historic lows to support economic growth.

"We are more optimistic for Europe than for some considerable time," says the CEO of a global advisory firm. "We have seen a material pick-up in our business in the last six months; not across the board but even the slower markets – Southern Europe and the Nordics – have stabilised and started to improve. The core markets of the UK, Germany and France have picked up strongly. This is due to a lot more money coming into the market from investors."

It says something, too, about the improving conditions and confidence that the biggest perceived issue facing the industry is a shortage of suitable assets to buy (see Figure 4). That in itself is prompting many to be bolder when it comes to their strategy for 2014. As one pan-European fund manager says: "There remains an appetite for yield but the economic backdrop is inviting investors to consider more positively putting more risk on the table."

Equity gush

Direct investment in European real estate is "almost back at the pre-crisis level" and the impetus is attributable to sovereign wealth fund capital, much of it from Asia.

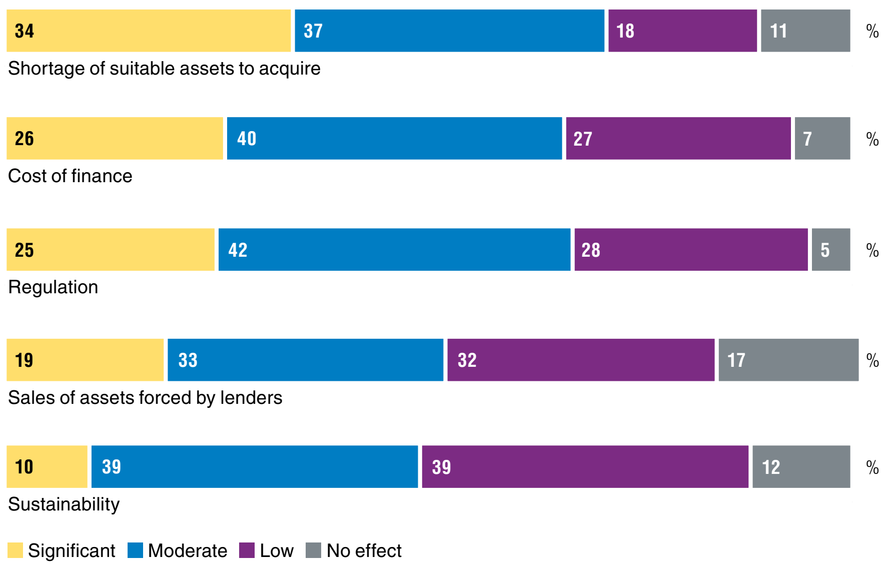
Interviewees and respondents to the survey are as one in proclaiming the continuing dominance of the sovereign wealth funds and their flow of capital into core property. "We're optimistic that these new sources of capital – a lot of which are recycled savings from emerging markets that are doing quite well – need to diversify and invest overseas," says one interviewee.

"There is so much Asian capital coming into Europe," says a pan-European fund manager, "even if you pick up a small bit of this capital it's actually very significant for you as an individual fund manager."

Nearly 80 percent of respondents believe that capital from Asia-Pacific will increase during 2014. The other big capital source is the Americas, and here two-thirds of survey respondents expect an increase of funding in 2014 (see Figure 5).

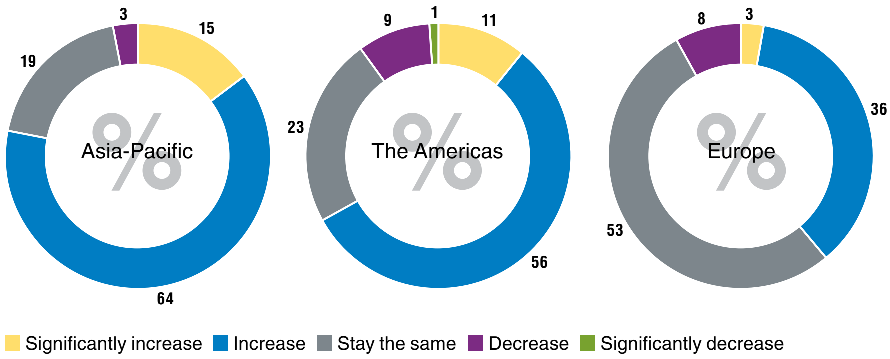
There are encouraging signs that this strengthening of cross-border flows has emboldened domestic institutions, especially in the UK, which remains Europe's biggest and most liquid investment market. "The UK is still dominated by non-domestic providers of equity but as far as UK institutional money is concerned, that tap is starting to be turned back on," says one interviewee.

Figure 4 **Issues impacting business in 2014**



Source: *Emerging Trends Europe* survey 2014

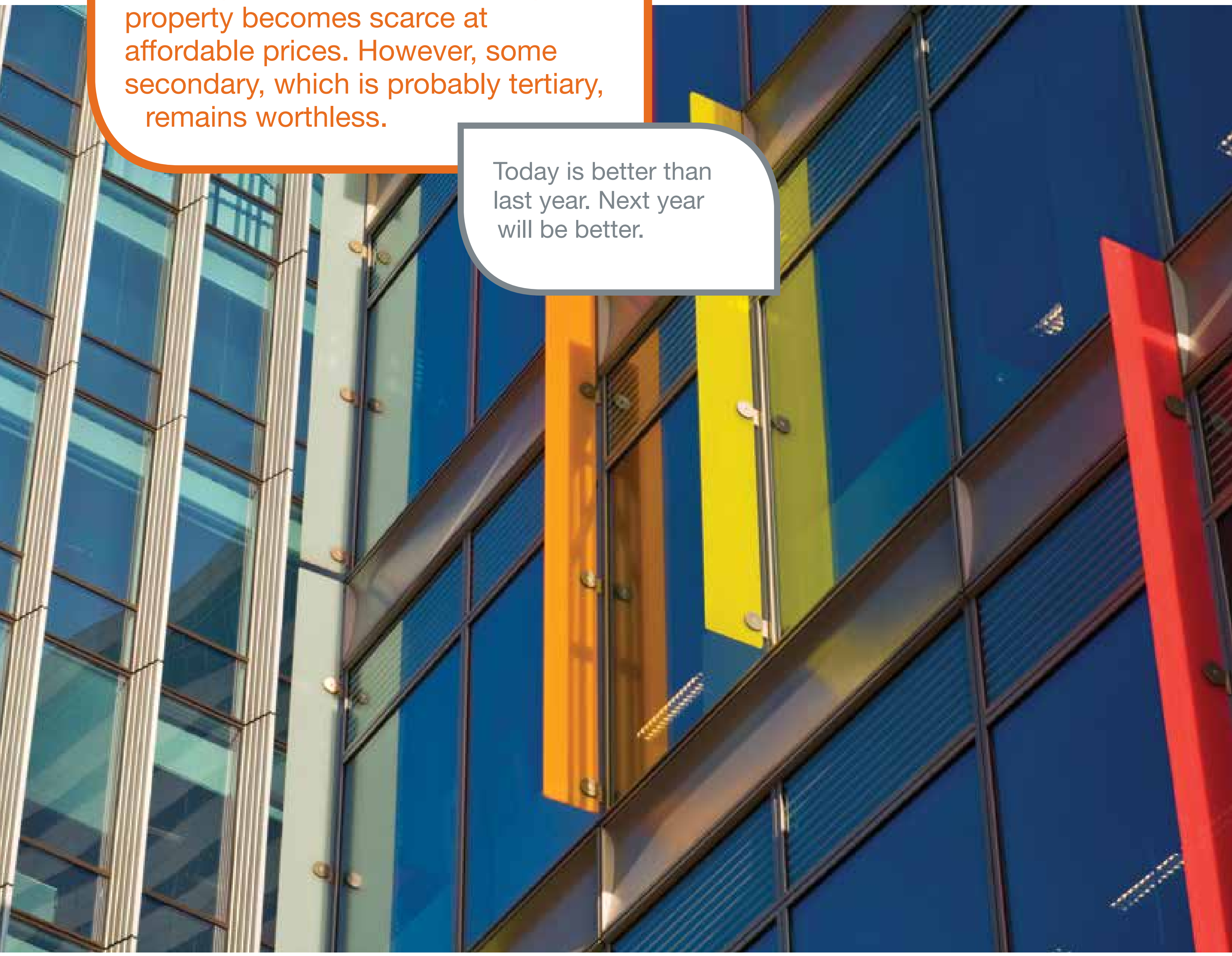
Figure 5 **Cross-border capital into European real estate in 2014**



Source: *Emerging Trends Europe* survey 2014

Secondary property has started to warm up and will accelerate as prime property becomes scarce at affordable prices. However, some secondary, which is probably tertiary, remains worthless.

Today is better than last year. Next year will be better.



Office buildings in Amsterdam, Netherlands © Alamy

This view is supported by Real Capital Analytics, which reports that the first three-quarters of 2013 saw investment activity across Europe increase 10.5 percent to €110.9 billion, with the UK accounting for €34.5 billion (see Figure 6). Domestic UK investors placed 90 percent more capital in Q3 than in Q2.

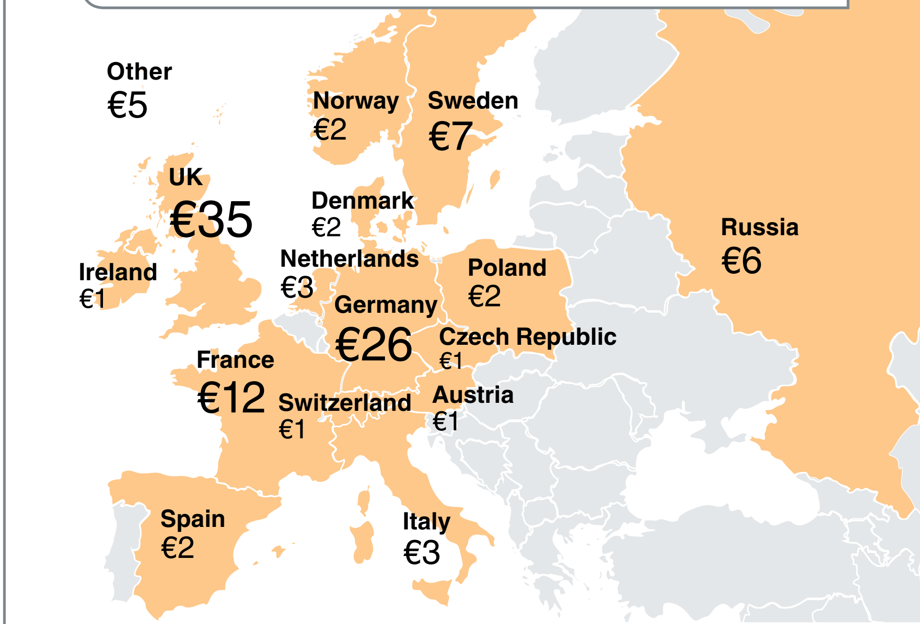
Interviewees and respondents across many European markets say that raising equity finance is not easy, as such, but it is easier than a year ago. "But always you need to have a good product," says one Polish asset manager with a Central & Eastern Europe remit. Indeed, "quality" will prevail, even in one-time no-go areas such as Greece. "If the right opportunity arises, there is a perception that equity capital will be around to fund it," says a Greek interviewee.

"It remains hard," says one European investment manager. "People are concerned about investing new money until they have got their old money back. Fund managers have not been returning a lot of old money because they feel values are still going up – so it's a bit of a catch-22. But things have improved materially from years past and at least investors are now willing to consider investing in an illiquid real estate fund."

Debt on the mend

Europe's debt providers are similarly more willing to lend to property. Between them, the banks, insurers, debt funds and other alternative lenders are ensuring that Europe's debt market is "improving with each passing month", albeit still "a shadow of its former self". "This year there is more lending and the margins are improving. I do see it carrying on because the policy makers want to see it carry on and breathe life into moribund markets. But it's hard to get more than 60-65 percent leverage."

Figure 6 **Real estate investment in Europe, Q1–Q3 2013 billion**



Source: Real Capital Analytics

Even so, there are mixed feelings towards the new breed of lenders. Powerful groups such as insurers Allianz and AXA have been welcomed for "filling in some of the gap and creating a competitive environment". So too are the specialist debt funds, but they are "too expensive" for some. And in a tough market such as Italy, according to one local fund manager, they are "an irrelevant market niche".

"They see a gap in the market and they're well financed but there has never been a better deal for property companies than a bank, and thank goodness they're still there," says the managing director of a quoted UK company.

But he adds: "The banks are going to be very difficult lenders to real estate over the next two to three years, and particularly hard for private companies."

UK and German banks in particular are expected to originate more real estate debt in 2014, which reflects their positive view on the market. "We definitely consider ourselves in the growth phase," says the property director of one UK bank.

According to the CEO of a multinational REIT: "If the product is good enough, equity will be there. And the banks are just like investors. When they come back into the market, they will focus first on the quality assets before going for the more time-consuming and tricky deals."

Prime assets are over-priced

Battle for assets

As investors increase their allocations to property, there has been a "huge capital push" into core European markets, which will continue through 2014. The implications are many and varied.

Interviewees and survey respondents talk of "pricing bubbles" and "markets over-heating" – the language of the pre-financial crisis era. This is a cause for concern for some and an opportunity for others.

"We've seen prices go up and I think they have a little farther to go but eventually the markets are not going to make sense. Certain markets, like London and Germany, are starting to reach a critical point," says one lender. "Some of the investors from the US and Asia are investing in big lot sizes in markets that they may not have spent much time in at all. There will be some miscalculations when you have that much money chasing something that is of limited supply."

Jones Lang LaSalle's pan-Europe forecast for prime capital values in 2014 is a more sober 4 percent growth for offices, 1 percent for industrial and 4 percent for unit shops.

Low Euribor and Libor rates provide the backdrop to this modest growth and some – by no means all – respondents expect a rise in 2014. "We are starting to see pressure in the bond markets and this will affect swap rates," says one UK interviewee. "However it would have to be a meteoric rise to start changing the direction and velocity of the marketplace. Real estate is still seen as a good diversifier and a good way of getting dividend, and I don't see that changing."

The big unknown, though, is occupier demand. "Until we see strong rental growth returning I don't think we'll see a lot more movement in capital values."

One global fund manager says: "If there is a risk scenario today it is that capital flows may be getting ahead of underlying fundamentals. In a lot of markets there is limited rental growth but capital is available to buy."

Others are far more sanguine about the weight of capital on core markets. "The most important impact is that it absolutely locks in demand for quality product," says the director of one REIT. "The large, global investors are looking for predictable, secure, long-term returns and as a consequence they're looking for high-quality product. They're not looking to make a 40 percent return in one year but a steady 7 or 8 percent year after year. That locks in support for pricing, which is relevant to our business."

According to others, many of the sovereign wealth funds also "lock assets up for a long time", which is at odds with the normal trading patterns of domestic investors. Either way, with a quarter of all survey respondents predicting a fall in the availability of prime assets during 2014, something has to give.

Across Europe, many domestic institutions and some of the smaller cross-border investors are increasingly looking beyond the main markets and bidding for good income-producing assets in regional cities. "London is fairly fully priced and now needs rental growth to deliver returns," says a UK interviewee. "Because of that a lot of the UK institutions are going into the regions again. That's a big improvement in the market – one thing that has been missing – and it will broaden."

"We've been buying in Stuttgart rather than Munich and getting 6.5 percent yield rather than 4 percent. For that kind of office stock we've seen steady uplift," says a pan-European fund manager.

Others are moving still further up the risk curve. "There's an opportunity to progress and put more money into development over the coming year."

Though increasing debt availability is enabling developers and investors "to gear up across an increasing risk spectrum and geographies" it remains under control, insists a global investment banker. "There is not the same amount of leverage. All this capital that has gone into the sector has gone in with much lower debt, which means it is going to be a much more stable environment."

Yet this same search for value and yield – as well as diversification – is taking increasing numbers of mainstream investors into alternative asset classes, such as data centres and student accommodation. The latter is part of a bigger, positive shift in sentiment towards residential investment, which remarkably is judged to have better prospects than core commercial real estate for 2014.

"It seems very clear that capital – debt as well as equity – is looking at a much broader range of assets than was the case even a year ago," concludes one interviewee. "That's partly down to the competition for prime assets and how difficult finding value there has become. This is good news, because towns and cities outside the prime centres have been starved of the capital investment they need over the last five or six years."

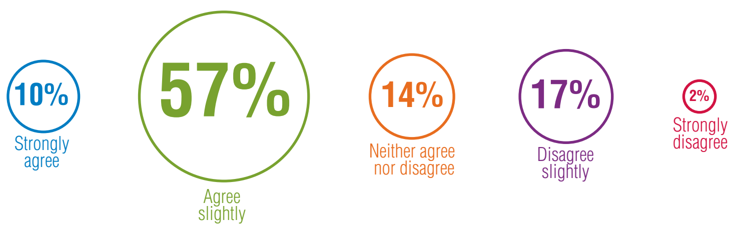
75% have a sustainability strategy in place.

Next stop… Spain

The extraordinary turnaround in sentiment towards Spain is one of the most remarkable property stories of this year's *Emerging Trends Europe*. Within weeks of the country's bad bank, Sareb, opening for business last summer, the rush of opportunistic investors into Madrid and Barcelona had turned into a veritable stampede. By the autumn, Spain's transformation from property pariah to star market was complete. By all accounts, the revival is expected to continue in much the same vein in 2014.

"As we have seen with Ireland, 24 months ago no-one wanted to know. Now it's the darling of the market," says one interviewee. "There is way too much capital chasing product in Ireland and that's why Spain will also recover because all the investors in Ireland have moved down to Madrid."

There are now good buying opportunities in Spain



One pan-European fund manager believes mainstream institutions will be giving the opportunistic investors a run for their money in Spain before too long. "We think that it is a medium term play rather than immediate – but it is coming back. You will see one or two benchmark deals, which gives confidence for others to go in on the best stock in the best locations."

Some believe that one of those benchmark deals took place as early as last autumn when leading UK-listed shopping centre owner Intu and the Canadian Pension Plan Investment Board paid €162 millon for Parque Principado mall in Oviedo, northern Spain.

However, there are also many dissenting voices who say Spain remains a distressed market rather than anything more sustainable. Though the investment volume for the first three-quarters of 2013 soared 198 percent, according to Real Capital Analytics, it was off a very low base – the total was just €2.4 billion. Debt, meanwhile, remains extremely hard to come by in Spain.

The sceptics also argue that the disconnect between capital flows and occupier demand and rental growth is more extreme here than anywhere else in Europe. "It remains a dangerous market to be investing a huge amount in before there are some signs of growth, and at the moment that's pretty anaemic."

And according to one pan-European fund manager, the risk of Spain leaving the eurozone is still pertinent. "Even if it is a small probability, it's a small probability of a gigantic thing happening and you will lose 30 percent of the value of your property and income overnight, and you'll never get it back. I just don't think the Euro crisis is in any way over."

Sustainability matters

The business case for sustainable real estate is starting to take hold across the industry, six years on from the financial crisis.

Over three-quarters of survey respondents have a sustainability strategy in place, but no longer solely to comply with domestic and EU regulations.

In the post-crisis marketplace, there is growing recognition that green buildings form part of "a consolidation of quality" and therefore "a winning differentiator" in the eyes of potential occupiers.

"Sustainability will matter increasingly both in terms of getting tenants to commit to a building for a longer time and with the end-investment value," says the CEO of a global investment firm.

Half *Emerging Trends Europe*'s respondents believe that going green has led to them achieving higher rents, which is arguably one of the most extraordinary results in the survey and hard to have envisaged in previous years.

As one interviewee observes, "The risk is if you have a property that's no longer viewed as modern or green you could see your effective rent drop 30 to 50 percent. It is not just a matter of rent… covenant quality will drop too."

Even those who remain unconvinced that there is a strict correlation between sustainability and rents, recognise that green buildings offer protection from obsolescence while keeping operational costs in check.

In any event, the common view among respondents and interviewees is that investors and developers play down the possibilities of sustainability at their peril. It appears that in its search for value, sustainability represents one more, increasingly important, business opportunity for the industry.

Best bets

Seek out assets in fast-growing secondary locations and larger, regional cities

Pricing of core properties looks increasingly prohibitive, but there is still good value to be found for high-quality, income-producing assets on the fringes of the CBD or in the larger regional cities. Many of these markets benefit from solid and diverse economies. The next phase of the cycle will likely see occupiers relocate to these areas, a movement that should support growth in rents and values.

Sign up for Spain but follow the tourist dollar

Spain comes with a health warning, but investment momentum is building. Opportunity funds will feast on distressed assets; investors with a longer view can take heart from the recent significant rise in tourism numbers and the fact that a lot of investment in infrastructure has already been made. Retail, hotel and leisure sectors are worth considering.

Get smart with sustainability

Corporate occupiers will toughen their stance on sustainability, leaving many buildings falling short on green credentials and ultimately obsolete, even in prime locations. Smarter investors have already traded out their more challenging assets. But there are still opportunities to sell such stock to opportunistic investors that are after a short-term yield play or retrofitting.

Drill down to demographics

Europe's population is changing, with important consequences for real estate. Aging baby boomers will need more healthcare and retirement homes, while Generation Y – the under-30s – has different expectations and lifestyles to their parents'. Independent and tech-savvy, they want workplaces that are open and allow tele-commuting and hotelling; they're not keen on owning houses in distant suburbs, preferring to rent in urban cores or "urban-light" suburbs that offer good transport and a social hub. Understanding these changing patterns – in countries, cities, neighbourhoods and buildings – will give investors and developers an edge.

Explore alternatives

Real estate is moving beyond offices, retail and industrial to sectors that offer good yields and stable income streams that are not pro-cyclical: student housing, healthcare, retirement homes. Debt too is becoming mainstream. But beware: these require operating expertise and scale.

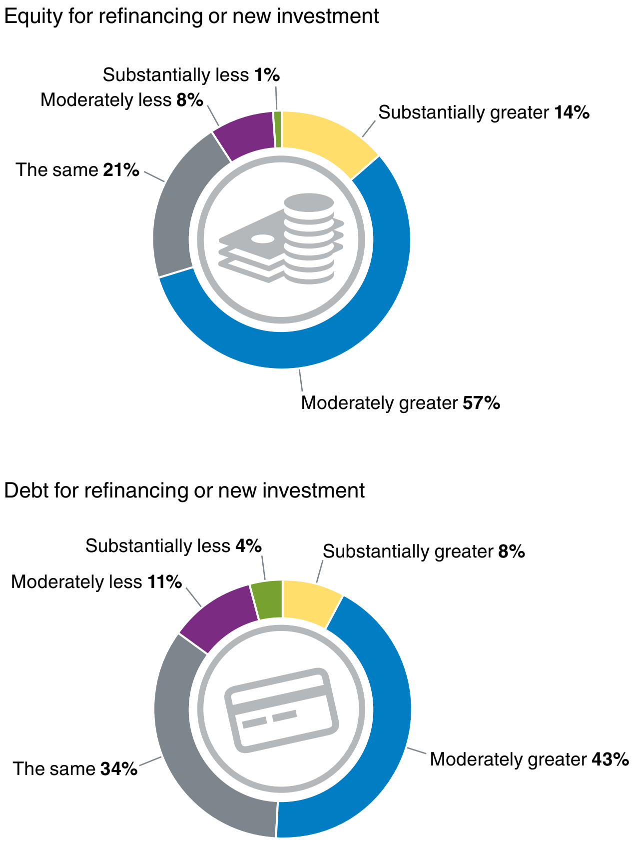
Consider co-investment

The competition for assets is so intense in key sectors that there is a high risk of failing to execute the deal on any asset that comes on the market. Hooking up with a local partner will mean relinquishing some control, but can provide superior market intelligence about assets to target and avoid, as well as a head start on the competition.

Real estate capital markets

Allocations to prime real estate among European debt providers and equity investors are expected to continue rising in a sustained, albeit gradual, opening up of capital markets over 2014.

Figure 1 **Availability of equity and debt in 2014**



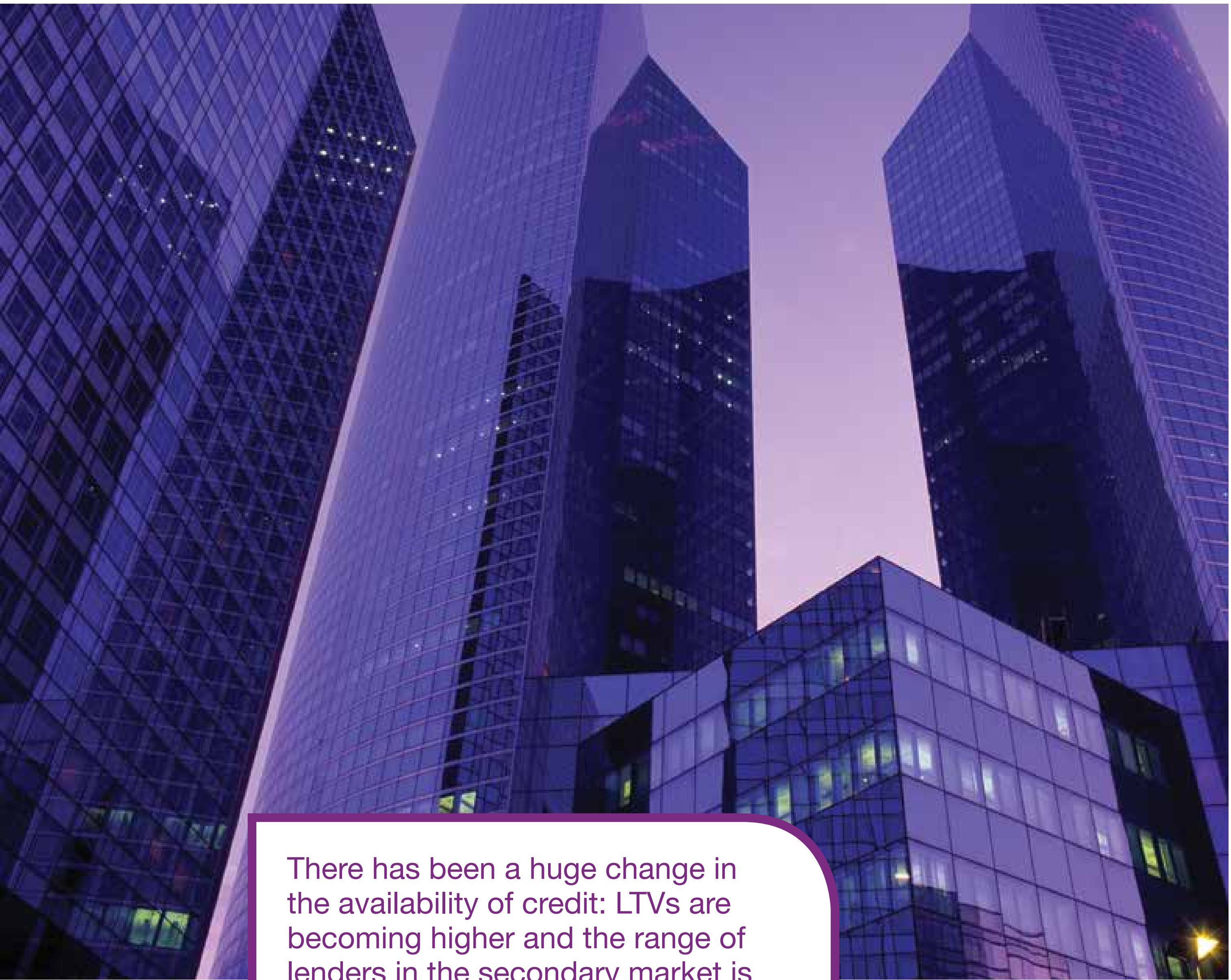
Source: *Emerging Trends Europe* survey 2014

The real estate sector is in "expansionist mode" when it comes to core markets, with both lenders and investors playing their part. "It's still taking an inordinate amount of time to get things done because of where we've come from," says one pan-European investment manager, "but activity is up and I anticipate it accelerating."

Securing debt and equity may take time, but at least the tap has been turned on (see Figure 1). *Emerging Trends Europe*'s survey shows a significant upturn in expectations for 2014. More than 50 percent of respondents say availability of debt for refinancing or new investments will be moderately or substantially greater. For equity, they strike an even more bullish note with nearly three-quarters expecting greater availability.

Such sentiment is in stark contrast to last year when much of the industry was "off limits" to capital markets. And yet the improvement owes little to underlying economics or occupier demand. As one institutional fund manager says, "This scenario is not about the prospect of immediate or, in some cases, even medium-term rental growth. This is about weight of money and relative pricing of real estate compared to other asset classes."

Another concludes: "Now people are gaining a little confidence, they can tolerate some illiquidity. Property is seen as one of the few remaining asset classes that look relatively high yielding for relatively low risk."



There has been a huge change in the availability of credit: LTVs are becoming higher and the range of lenders in the secondary market is expanding rapidly.

La Défense, Paris, France © Alamy

There is money to invest. The only problem is finding a good opportunity.

Debt dials up

Debt is the lifeblood of property, and it is starting to flow across Europe. Though no-one is getting carried away, the balance of expectations in favour of more debt availability in 2014 is evident in most of the countries and regions surveyed.

The UK is clearly most upbeat about access to debt with nearly 90 percent of its respondents forecasting greater availability. But all the major markets – including Germany, France and the Nordics – are positive (see Figure 2).

"A lot of traditional lenders are progressively returning to the market and increasing their allocations to property, providing it is not too highly geared – 50 to 65 percent loan to value on the right assets and the right customer," says one interviewee. "It is not easy to get it but it is possible."

Ireland's increasingly vibrant investment market, meanwhile, is reflected in the fact that all of its respondents anticipate the same or more debt this year. A similarly optimistic mood pervades Central & Eastern Europe, where half those surveyed believe the lenders will be more generous than a year ago.

Elsewhere, the outlook is mixed. Unsurprisingly, Portugal, Italy, Greece and Spain are less positive than the rest of Europe, while a significant number of respondents in the Benelux countries – 27 percent – believe the availability of debt will fall in the coming year.

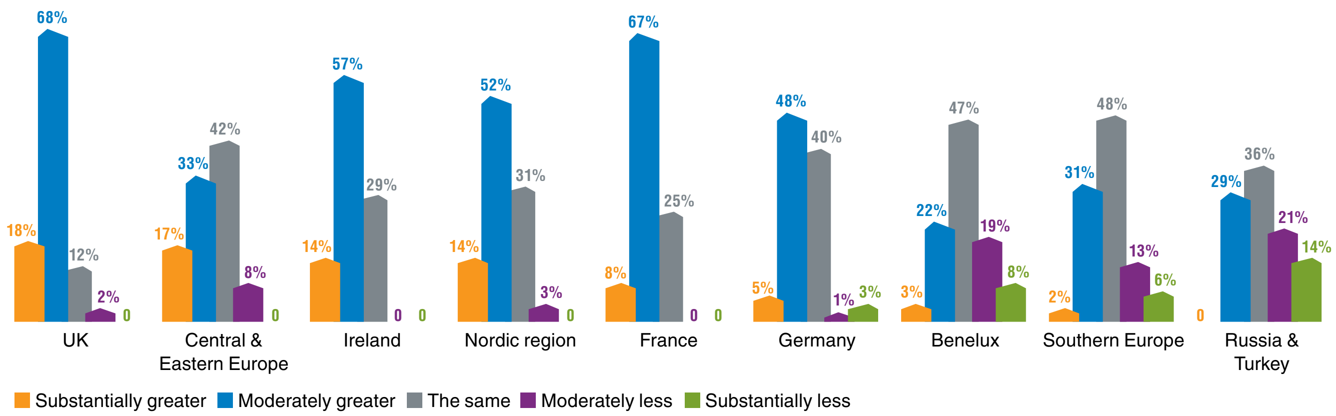
But behind the headline results, the European debt story is full of nuances and varied experiences for borrowers. The robust credit ratings of the major, publicly quoted real estate investment trusts (REITs) have ensured "a tremendous reception" when they have tapped the corporate bond market. But they also still rely heavily on their banks, and those relationships remain, by and large, strong and productive. Access to debt is "disturbingly easy", according to one UK REIT.

This largess doesn't extend too far, however. Banks are still "very strict" on whom they will lend to. "Listed property companies have survived well with their banks but private companies are still really struggling and will continue to do so."

There is widespread acknowledgement, meanwhile, that those German banks "that survived cleanly" are once again a big influence. "The German banks are out like a storm now, their budgets are significant. They are doing a lot of financing and they are chasing a lot of deals," says one interviewee.

Banks elsewhere, however, remain "schizophrenic" as they continue grappling with "conflicting pressures to lend more and shrink their balance sheets". Consequently, they tend to be "friendlier" towards investments and projects in their home countries.

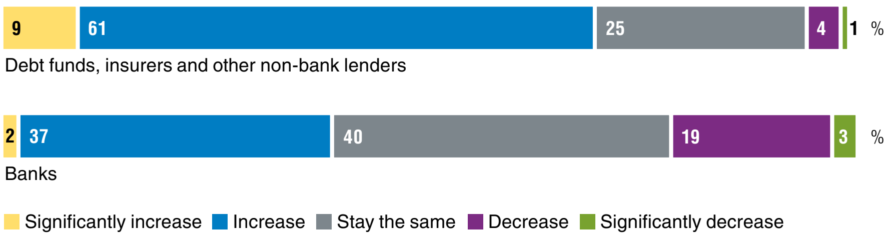
Figure 2 **Availability of debt across Europe in 2014**



Source: *Emerging Trends Europe* survey 2014

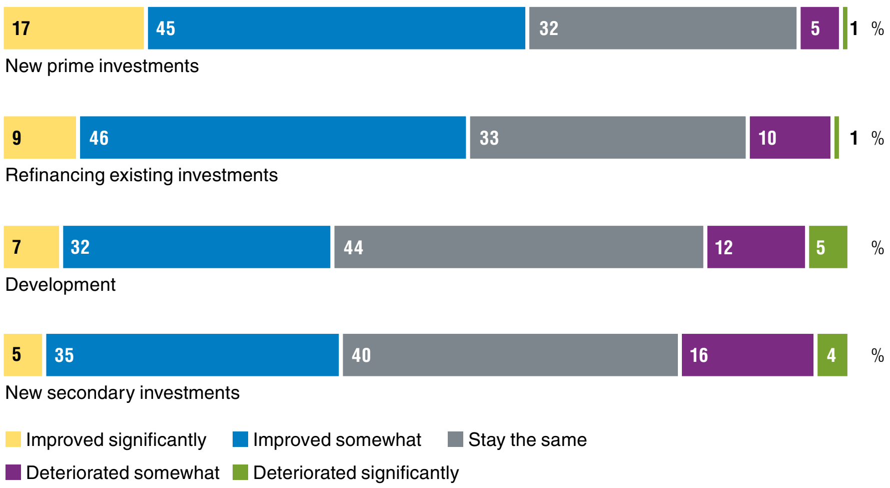
The survey results are correspondingly mixed. Nearly 80 percent of respondents believe the provision of debt by the banks will stay the same or increase in 2014. But 22 percent predict a fall (see Figure 3).

Figure 3 **Sources of debt in 2014**



Source: *Emerging Trends Europe* survey 2014

Figure 4 **Ability to secure senior debt in 2013 compared to previous year**



Source: *Emerging Trends Europe* survey 2014

The funding gap is being partly filled by specialist funds and a strategic expansion by insurers into debt finance. According to Preqin, there were 17 Europe-focused debt funds in the market, targeting $US12.4 billion in August 2013. Borrowers are benefitting from the increasing competition and that trend looks set to strengthen in 2014.

Some are wary of debt funds: “They will be the fastest flash in the pan. Most of them will be gone in two to three years because the returns they have promised people will turn out to have been ephemeral. They are a short term opportunity.”

There are signs, meanwhile, that commercial mortgage-backed securities (CMBS) is re-emerging as a source of debt in Europe. Last year’s issuance leapt to €5.4 billion, boosted by investors’ enthusiasm for bonds backed by German multi-family housing. Nearly half the survey respondents believe CMBS will increase in 2014.

Over half the respondents say their ability to refinance existing investments with senior debt improved during 2013, and nearly two-thirds found it easier to fund acquisitions of prime stock (see Figure 4). However, securing finance for development and new secondary investments remains problematic.

“There is more competition among lenders and that is affecting spreads and margins on transactions,” says one pan-European investor. “There is availability of debt for the best quality, income-producing assets in the better locations. But you don’t have to move far from that and you get a significant thinning of the market.”

Equity escalates

Ever-increasing equity is being pumped into European real estate, but this is by no means an even distribution of money – there's a clear trend towards "a polarisation of capital-raising".

Though institutional investors are increasing their allocations to the asset class, they are no less demanding than before.

As one pan-European investment manager puts it, if there are 100 fund managers in Europe, 20 are raising money and 80 are not. This is not just about track record and performance but investors "trusting" their managers to be appropriately staffed to manage assets in all jurisdictions, and not to operate simply as financial allocators of capital.

"That's why we have seen and will continue to see some fund management platforms being sold. They are running out of money because they have significant operating losses because of the climate we're in, or they cannot raise any new equity."

Although fundraising remains challenging, some strategies are having more success in attracting capital (see Figure 5). Debt funds are extremely popular with investors. The real estate funding gap in Europe has opened the door for these new lenders, who can offer investors asset-backed yields that are higher than what they are getting on other debt.

Opportunistic funds, too, are raising significant sums to spend in Europe from investors, particularly US institutions, who have decided that markets here have bottomed out. But track record is critical; capital flows to the big, established brands or boutique players who have proved their worth.

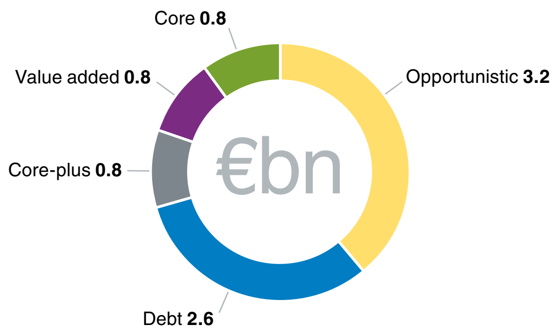
It is not just about performance; investors need to be convinced that there is "a good investment story", which is why some managers of discretionary pooled funds are also struggling to raise equity. "It depends on what you are trying to do," says one interviewee. "If you have a project or an individual asset that needs fresh capital, it is a little easier. If you are trying to raise a new fund there is still very little institutional capital available."

Those principles apply equally to leading REITs, all of which exude the same confidence as the heavyweight investment managers. Shareholders "don't like the idea of raising money in a blind pool", but if there is a specific project or corporate acquisition then "you're potentially pushing against an open door". In 2014, there will be selected, targeted equity raises "in the 10% cash box style" from companies who are keen to pursue opportunities and take investors with them.

Thus, both the fund management community and property companies are dividing into the 'haves' and the 'have nots'. Says one pan-European fund manager: "We've raised equity successfully over the last couple of years but nowhere near the amount we wanted, and we got it from seven different countries. You've got to go far and wide for it, and work hard for it. And that will continue."

71%
say there will be more equity in 2014.

Figure 5 **Capital raised by private equity funds for European real estate in 2013**



Source: Preqin

A crisis is too good a thing to waste, and we have taken advantage of it to become more efficient, cement our long-term debt funding and build our pipeline of opportunities.

Accessing equity is easy for companies with a sound track record and clear objectives.

Pierhead Street car park, Cardiff, UK © Alamy

Risk on

With greater access to debt and equity has come “an enormous capital push” into European real estate, which interviewees anticipate will translate into a 10–15 percent rise in investment volumes in 2014.

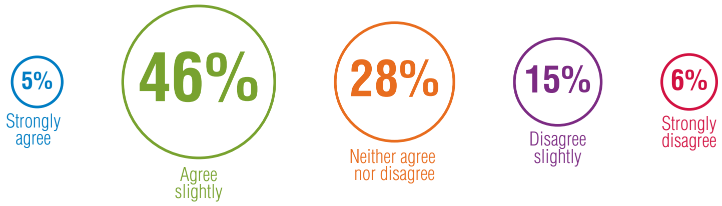
“The sense out in the marketplace is that Europe is where the value is going to be in the coming years,” says one global adviser. “We’re expecting to see more equity coming into the sector across Europe in a publicly listed form, either through IPOs or just companies raising capital. We see the main focus, still, as the UK and Germany.”

As far as sovereign capital from Asia and the Middle East goes, the main beneficiary to date has been London, where interviewees talk of “£8 of equity for every £1 of available property”, a potential price bubble in the making and therefore a broadening search for value (see Figure 6).

“A year ago people thought the eurozone was going to dismantle and that we would have a two-speed eurozone,” says one fund manager. “But now that the perception of currency risk is lower, that may mean some of this global capital will find its way into quality assets in the major German and French cities.”

It is just as likely, however, that this search will lead investors beyond prime markets. As one interviewee says, “US money tends not to play in London”, because it is too expensive, but will instead invest in quality secondary in the regions.

There are now good buying opportunities in Ireland

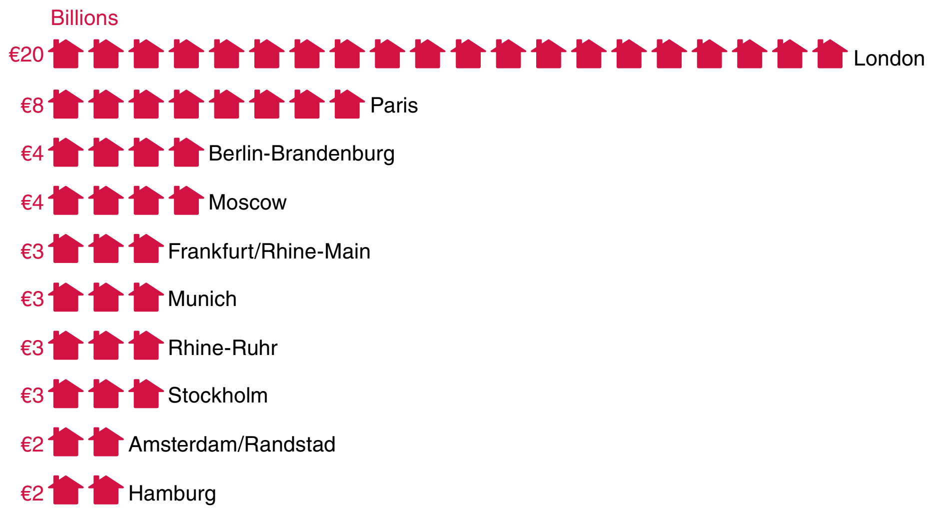


The US money is not alone. Nearly 60 percent of respondents to the *Emerging Trends Europe* survey believe that prime assets are overpriced. This chimes with research by Real Capital Analytics, showing the start of a shift by global and European investors in 2013 from ‘Tier 1’ cities like London and Paris to ‘Tier 2’ cities such as Frankfurt and Stockholm (see Figure 6).

This movement of investors up the risk curve will gather momentum in 2014. “If we were bidding on assets 12 months ago, chances were that we were the only bidders,” says one UK fund manager, who has been buying regional real estate for five years. “Now you can have 12 or so bids for the same kind of assets. It has become highly competitive and yields are coming down quite rapidly.”

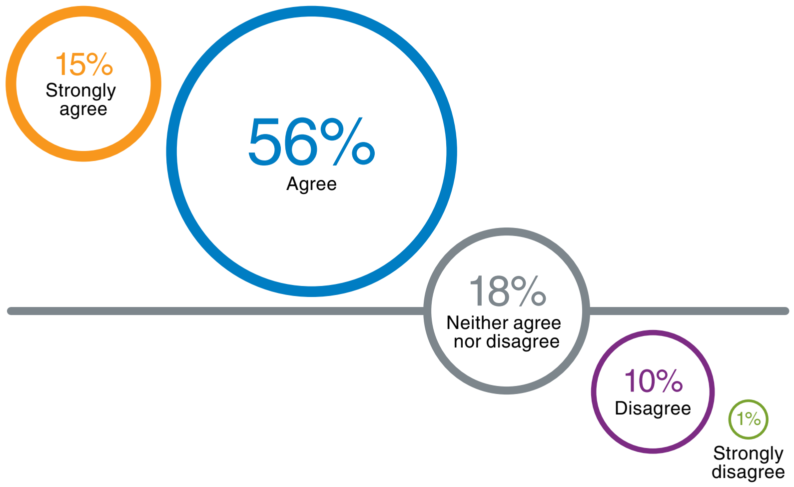
Development is another route up the risk curve, and 71 percent of respondents to the survey regard it as an attractive means to an end product (see Figure 7). “Core property has become increasingly expensive so if you can manufacture to core you feel highly optimistic about your ability to sell,” says one interviewee. “For quality, income-producing property in major markets, the demand continues to grow. We’re doing projects in London and we feel pretty confident about selling them.”

Figure 6 **Europe’s ten most active real estate markets, Q1–Q3 2013**



Source: Real Capital Analytics

Figure 7 **Development is an attractive way to acquire prime assets**



Source: *Emerging Trends Europe* survey 2014

Spanish surge

But the biggest revelation is the capital movement into Spain, which has turned that market from "zero to hero overnight". It is not so much a search for value as "a lemming-like" scramble, according to some sceptics.

Investors have shrugged off any fears of a eurozone break-up and alighted in Madrid and Barcelona, following the establishment of Spain's bad bank Sareb in summer 2013. For many it is a rerun of what went on earlier in Ireland and that country's National Asset Management Agency. "It is about the opportunities becoming unlocked with the whole banking sector dealing with its portfolios and loans issues," says one interviewee. "The difference with Spain is that it has been so fast."

A pan-European fund manager says: "A lot of the American distressed-bond, value-driven arbitrage funds – who often don't do real estate – are not finding enough arbitrage and distress in America, and so they're over here. Will their interest continue through 2014? Definitely."

Another interviewee concludes: "My concern is that this is driven by the buy-side rather than sell-side. I do expect to see quite a lot of deals done in 2014. But in five years' time, I think people will look back and see this as one of those experiences they would rather not talk about."

39%
say there was more debt for development in 2013.

Attractive alternatives

Quality of income is paramount for many investors in their search for value, which is one reason why both the investment and development prospects for student housing are judged to be better than any other property asset class in this year's survey (see Figure 8).

Purpose-built student accommodation exhibits some of the same benefits that draw global and institutional investors into mainstream commercial real estate: the opportunity to invest at scale, allied to long-lease income and covenant strength.

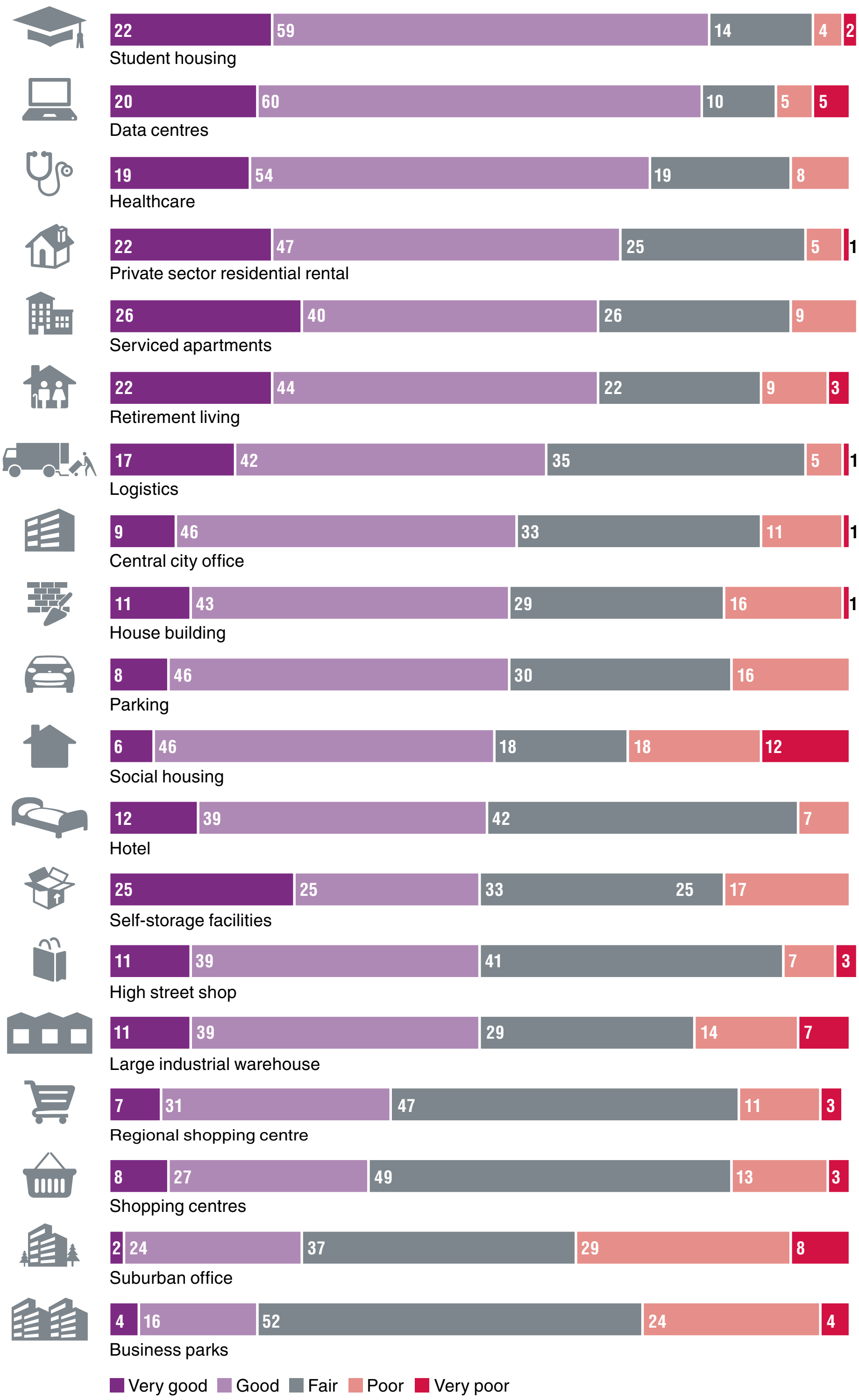
With growing numbers of overseas students descending on leading universities across Europe, the market dynamics are only getting better. As one interviewee suggests, student housing is "a product that is needed in France, Germany, Spain and Italy".

Even in the UK – the most mature student housing market outside North America – demand far outstrips supply in many university cities, which is compelling enough to have generated about $US3 billion of investment deals a year for the past two years. US investors have led the way.

Some regard student housing as "an emerging asset class in its own right", but it is also part of a wider capital play on residential. Private sector rental, serviced apartments, retirement living and housebuilding all rank highly in this year's survey in a way that was inconceivable a decade ago.

The attractions of residential are many and varied across Europe and yet two markets stand out among interviewees: the UK and Germany.

Figure 8 **Sector investment prospects 2014**



Source: *Emerging Trends Europe* survey 2014

Reichstag Dome, Berlin, Germany © Alamy

Global investors continue to back prime London residential. But it is now government support for the private rented sector nationwide that has provided impetus to institutional moves into "the biggest untapped investment sector in the UK – worth £4 trillion".

Others say that the recent rise in German listed housing companies represents "the biggest fundamental change in residential investment in Europe", despite the Deutsche Bundesbank's concerns about an overheating market. "You can't foist €8 billion of market capitalisation on investors who don't want it. I don't see this reversing in 2014," says one pan-European fund manager.

Were it not for this resurgent residential sector, supporters of such commercial real estate staples as central city offices and logistics would have held sway. For many interviewees, logistics is still the favoured sector in 2014, largely because of its e-commerce potential.

Retail real estate, long the darling of investors, is very much towards the bottom of the shopping list for 2014. The outlook for consumer spending is still predominantly gloomy and the turmoil created by online shopping carries on.

And investors' search for core-like quality income and assets in provincial centres is steering them away from business parks and suburban offices, leaving these sectors with dismal prospects for 2014.

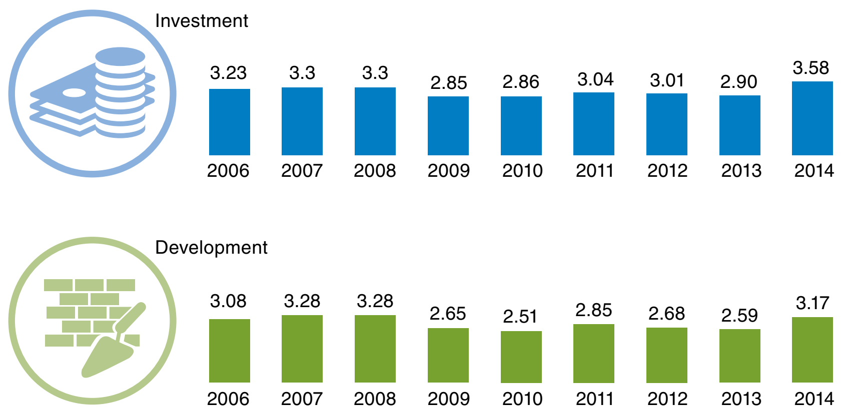
Markets to watch

Recovery is under way, and investments are back on track. That's the message that the European real estate industry is sending this year.

Optimism has returned and cities' prospects in 2014 are deemed to be considerably improved, indicating that investors are shrugging off their worries about the economy and beginning to see the green shoots of recovery.

The ratings *Emerging Trends Europe*'s survey produced for cities' prospects in 2014 are sharply higher than last year's: 3.58 for investment and 3.17 for development on average. These scores – equivalent to fair-plus and fair respectively, are among the best in nine years – a sharp contrast to last year, when they were among the lowest registered since 2006 (see Figure 1).

Figure 1 **Average city prospects, ranking out of 5**



Source: *Emerging Trends Europe* survey 2014

"The global financial crisis has been hanging around, which has been putting pressure on the market. It has taken a long time to go through the system. People are now looking forward than looking backward," says one interviewee.

Even debt-stricken Athens, which remains at the bottom of the pile for existing investment prospects and development, is posting better results this year. The city has jumped to Number 13 for new investments, signalling that some think Greece's distress will provide opportunities. But interviewees largely agree Athens is a market they prefer to avoid for now (see Figure 2).

The real surprise of this year's survey is Dublin. The city has zoomed into first place for new investments as equity floods in, residential prices rise sharply and predictions of significant growth in the office sector abound. But Dublin is a small market compared to European favourites London and Berlin, so opportunities will be limited.

The other outstanding rebound in the rankings this year is Spain, in particular Madrid and Barcelona. Interviewees are picking out Southern Europe as the place to invest, and Spain is benefiting from the size of its market and on bets that it will be the first in the region to turn around.

Opportunity funds in particular are exploring Madrid and Barcelona, and deals will be forthcoming in 2014, especially as Spain's bad bank, Sareb, puts more loans and real estate up for sale. Core investors might be more reluctant to put their toes in the water, but discussions are certainly on the go.

The run for core in Germany is still ongoing.

We are starting to feel that we can take more risks.

"There are a lot more players – clients and investors – who wouldn't have looked two years ago but now are," says an interviewee. "The question is how much will they actually invest."

Elsewhere in Southern Europe, Lisbon has seen its largest real estate deal in four years, but interviewees say Portugal will need more time than Spain to turn around. And while foreign investors' interest in Italian cities such as Rome and Milan will depend on the country's political situation, the outlook for Milan's office market is positive.

But it's the four German cities of Berlin, Munich, Frankfurt and Hamburg that continue to garner high rankings, with Munich topping *Emerging Trends Europe*'s investment league for 2014. "In Germany further property price increases are likely. But it´s a question of time, how long this trend will continue," says one interviewee.

London too continues a firm favourite. Even though it has slid a bit down the investment league – and some think it too expensive – London remains key for all core players and sovereign wealth funds who value the size, liquidity and depth of its market. This intense competition for an ever-tighter supply of prime assets has propelled London to the number one spot for development prospects in 2014.

In contrast, Paris is one of the biggest losers in the rankings this year. Those surveyed downgraded it to Number 14 for existing investments, and Number 17 for new ones. However, despite an uncertain political situation, the government's flip-flops on taxation and concerns over France's indebtness, international investors are not likely to give up on the French capital and see it as a must-have in any portfolio.

Prospects for existing assets in Moscow and Istanbul have dimmed slightly as well, but both cities are still well-regarded for development: Moscow is Number 4 and Istanbul Number 6. Turkey's capital also maintains its Number 4 ranking for new investment.

Warsaw's market, the main motor of central European real estate, is faring less well. It is now considered as a core investment rather than an emerging market, and investors are starting to consider secondary markets such as Krakow or Wroclaw.

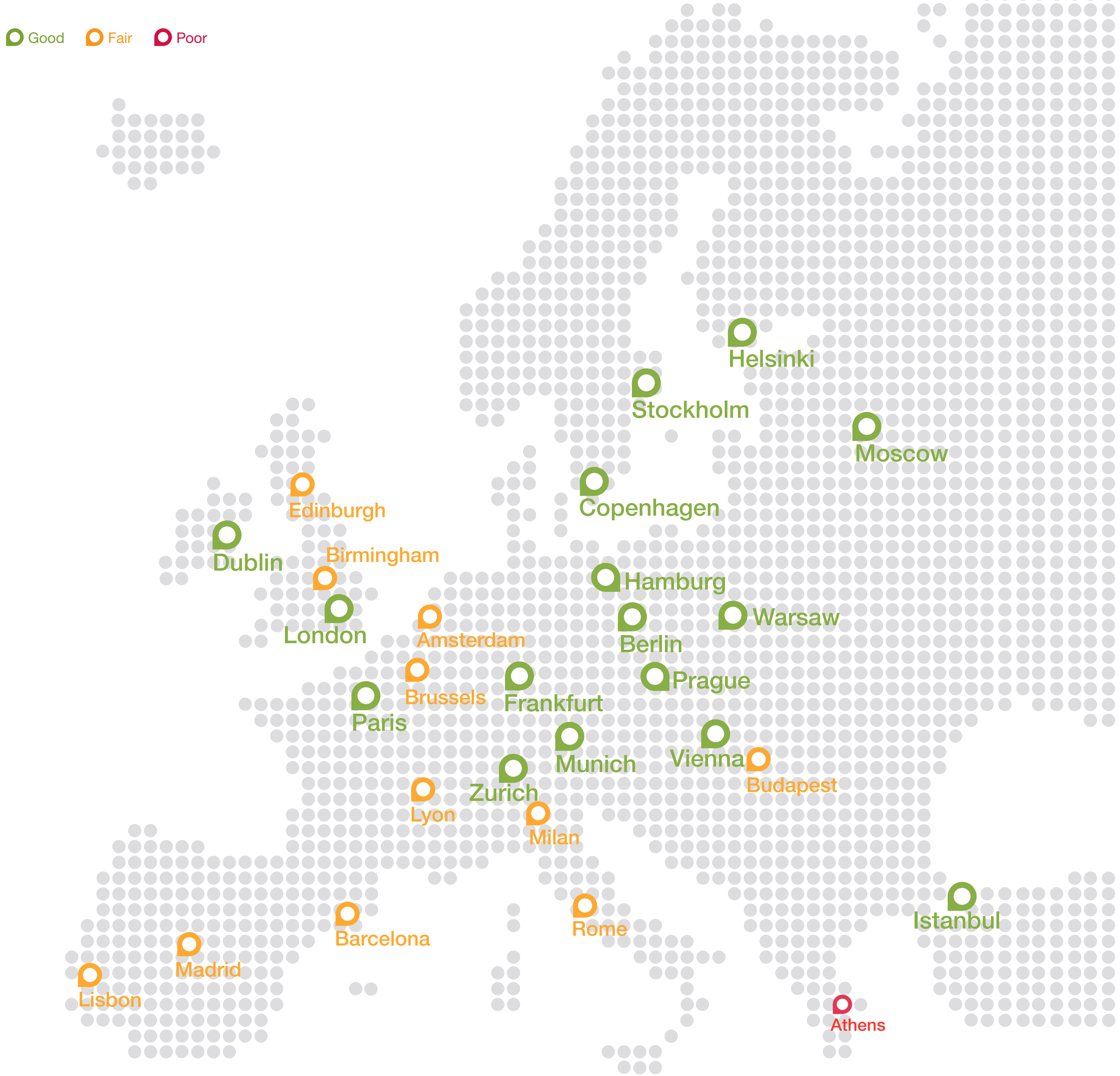
Budapest continues to be on a par with Athens as investors continue to avoid the city on concerns about politics and the general economic outlook.

And although this year's interviewees still favour London, the four German cities and perhaps Paris, the rise in prime property prices is encouraging many to look for non-core and secondary assets in those cities. The international and pan-European players among them will also eye other markets such as Southern Europe.

"There is very strong demand especially from Asian investors who are increasing their exposure in Europe. But we are entering a bubble situation where investors are going to have to find markets that are in less demand and have more reasonable prices."

Southern Europe will be THE topic in 2014

Figure 2 **City investment prospects**



		Existing investments	New investments	Development
1	Munich	4.21	3.67	3.86
2	Dublin	4.15	3.96	3.17
3	Hamburg	4.11	3.85	3.75
4	Berlin	4.09	3.81	3.72
5	London	4.05	3.76	3.94
6	Zurich	3.95	3.42	3.63
7	Istanbul	3.90	3.79	3.72
8	Copenhagen	3.89	3.64	3.16
9	Stockholm	3.89	3.65	3.50
10	Frankfurt	3.77	3.69	3.33
11	Warsaw	3.74	3.38	3.13
12	Vienna	3.71	3.56	3.27
13	Moscow	3.64	3.60	3.74
14	Paris	3.64	3.41	3.25
15	Helsinki	3.62	3.39	2.77
16	Prague	3.52	3.39	3.19
17	Edinburgh	3.43	3.42	3.00
18	Lyon	3.39	3.37	2.89
19	Madrid	3.31	3.61	2.43
20	Birmingham	3.26	3.37	2.78
21	Milan	3.21	3.33	2.59
22	Barcelona	3.16	3.48	2.38
23	Brussels	3.10	3.05	2.90
24	Rome	3.06	3.10	2.52
25	Amsterdam	3.03	3.40	2.43
26	Lisbon	2.97	3.00	2.15
27	Budapest	2.52	2.70	1.89
28	Athens	2.41	3.50	2.00

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. The ranking is on the basis of their prospects for existing investments.

Source: *Emerging Trends Europe* survey 2014

		Amount invested	Rents	Capital values
1	Dublin	4.00	4.04	4.23
2	Madrid	3.78	2.93	3.20
3	Berlin	3.68	3.70	3.83
4	Copenhagen	3.63	3.24	3.56
5	Zurich	3.61	3.26	3.47
6	Munich	3.58	3.69	3.69
7	Barcelona	3.57	2.68	3.12
8	London	3.57	3.66	3.65
9	Athens	3.56	2.50	2.50
10	Hamburg	3.56	3.53	3.53
11	Istanbul	3.53	3.41	3.65
12	Amsterdam	3.52	2.81	3.07
13	Milan	3.48	2.74	2.89
14	Stockholm	3.45	3.35	3.47
15	Edinburgh	3.44	3.37	3.39
16	Frankfurt	3.43	3.44	3.41
17	Prague	3.42	3.13	3.28
18	Lisbon	3.41	2.93	3.26
19	Helsinki	3.32	3.19	3.15
20	Warsaw	3.32	2.91	3.26
21	Paris	3.30	2.81	3.10
22	Birmingham	3.29	3.00	3.39
23	Vienna	3.25	3.09	3.21
24	Lyon	3.18	3.11	3.00
25	Moscow	3.15	3.44	3.52
26	Rome	3.07	2.67	2.82
27	Brussels	3.05	2.95	3.00
28	Budapest	2.96	2.73	2.76

Increase   Stay the same   Decrease

Note: Respondents scored cities' prospects for 2014 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 2014.

Source: *Emerging Trends Europe* survey 2014

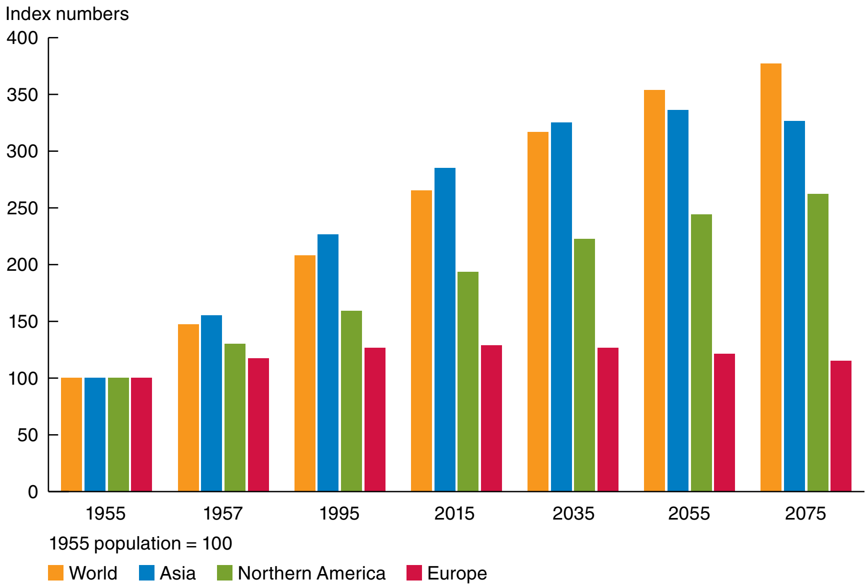
Demographics and winning cities

Demographic ageing is changing our society. We read all about the consequences of this trend for our health and pension systems. But what do population changes have in store for real estate markets? Professor Dirk Brounen explores European cities in search of an answer.

Commercial real estate success is a careful outcome of adjusting supply to changes in demand. This sounds fairly simple, but the past few years have proven otherwise. More and more cities and investors suffer from the painful side-effects of what economists like to refer to as 'disequilibrium'.

After several decades of growth and market expansion, many real estate markets in Europe have entered a new era in which success and returns are no longer yielded by tapping into a growth trend. Besides the apparent effects of the recent financial and economic dismay, demographics are often identified as a demand factor that is losing momentum.

Figure 3 **International trends in total population**



Source: United Nations

In a recent interview with Die Welt, KfW's chief economist Jörg Zeuner discussed his concerns about the outlook that by 2030, Germany's working population will have decreased by at least 8 percent. Zeuner calculated that this demographic trend will eventually slow down Germany's economic growth by almost 1 percent a year. But the effects of demographics, both on economic growth and real estate dynamics, have also been acknowledged by academics. Already in 1989, Gregory Mankiw and David Weil warned about the demand effects of demographic ageing in their paper 'The baby boom, the baby bust, and the housing market'.

Our demographic outlook

For commercial real estate markets, there is also a clear link between population growth and demand. In Figure 3, the international trends and forecasts of the United Nation's Population Division are plotted for both past and future decades. Populations have been growing on all major continents over the past 60 years. But demographic ageing is about to change this momentum, as young generations are small in size and the elderly are about to become a larger proportion of our society.

Figure 3 clearly shows that this demographic shift is most compelling in our part of the world – Europe. While Asian and North American populations continue to grow, Europe has reached its peak and is gradually transiting into a future where the annual outflow of elderly retiring from the labour force exceeds the number of youngsters that join in.

But the end is not near just yet. This demographic decline is not the same everywhere. In parts of Europe, like Scandinavia and Turkey, population will continue to grow. Moreover, whether this demographic trend also matters to the performance of local real estate markets still needs testing. Perhaps real estate entrepreneurs will manage to incorporate these long-term trends adequately in their plans for new supply, ensuring that a decrease in demand does not result in oversupply.

City populations and office markets

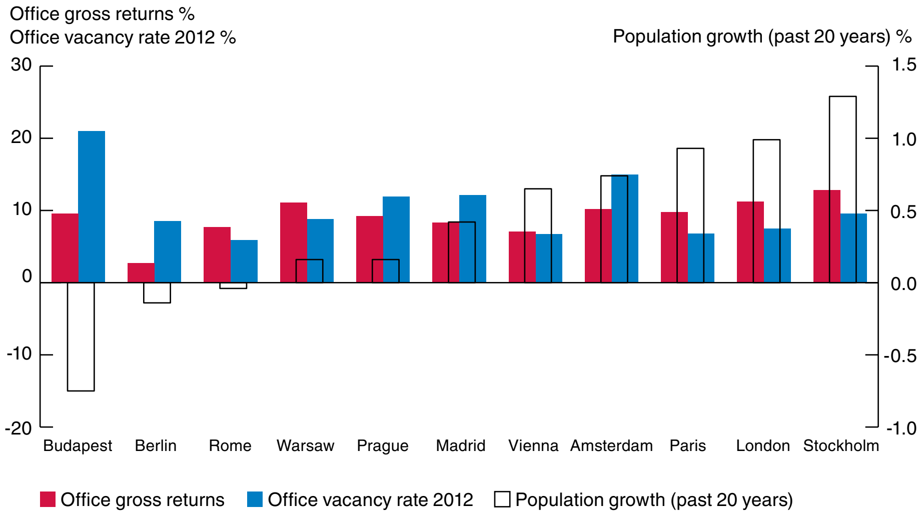
To empirically test the effects of changing demographics on local real estate markets, 11 European office markets are analysed. By matching the statistics on local population trends with the Jones Lang LaSalle's data on offices, new insights swiftly emerge. Figure 4 ranks the cities based on their population trends over the past 20 years, ranging from Budapest (-0.75% a year) to Stockholm (+1.29% a year).

To assess whether population growth and decline have had any pervasive effect on the performance of the local office markets, the corresponding office returns (red) and vacancy rates (blue) are also shown.

Overall, there is a positive correlation of 0.49 between population growth and office returns. The fastest growing cities – Stockholm and London – also delivered the highest office returns to investors, while in a city like Berlin, the absence of population growth coincides with weak returns to office investors.

The data also tells a clear story about population trends and vacancy rates. Here, the correlation equals -0.48.

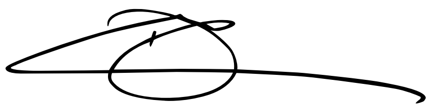
Figure 4 **City populations and office markets**



Source: United Nations

Obviously, one needs to treat the evidence from small amounts of data like this with care, but these first results indicate that growing cities face lower vacancy rates.

Again, this is no surprise, but Figure 4 offers a good indication of the strength of this effect. A shrinking city like Budapest faces the highest vacancy rates in the sample, while the blue bars of vacancy rates are lowest on the right side of Figure 4. Obviously, a sample of 11 cities and 20 years does not answer all questions, but clear traces of demographic effects are to be found in European winning and losing cities.



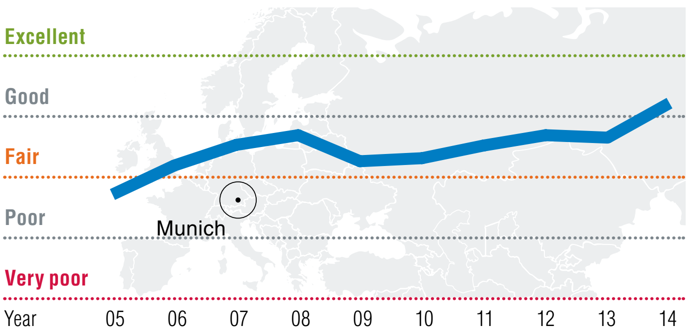
Dirk Brounen
Professor of Real Estate Economics
TiasNimbas Business School
Tilburg University, the Netherlands

The cities

Every year, *Emerging Trends Europe* analyses the real estate markets in major European cities and ranks them according to their investment prospects, as shown earlier in Figure 2. This section shows how their investment prospects have changed over time, as indicated by the respondents to the survey. The number in parentheses next to the city is its ranking for existing investments in 2014, while the graph shows the prospects for existing and new investments combined since 2005.

Munich (1)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

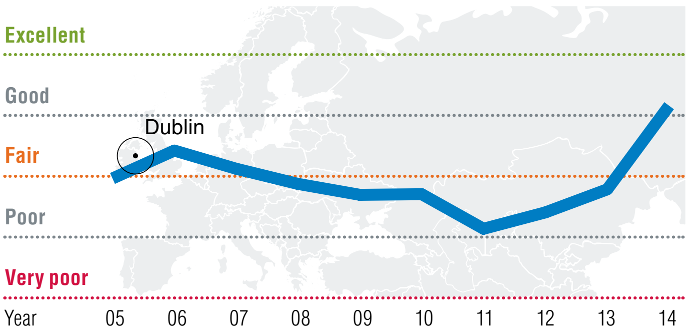
Munich still tops the bill for existing investments, but falls to Number 7 for new ones, down from the Number 1 position last year. Development prospects are still considered fair at Number 2 after London's.

Its fall for new investments may be down to the fact that many are beginning to see the city's offices as just too expensive. "The focus will turn away from the German 'big seven' to B cities in the future." Others have switched their attention to the outskirts rather than Munich's prime CBD.

But Munich benefits from Germany's position as the economic strongman of Europe and continues to attract core investors who single out its "very low unemployment and lack of high-quality office buildings". It has a bustling retail market, a strong, service-based economy and a young and growing population.

Dublin (2)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

The Irish tiger will make a comeback in 2014 as investors plough back into Dublin, which is expected to fire ahead on recovery hopes. However, opportunities will be limited because of the size of the market.

Dublin is by far the winner in this year's ranking, zooming to the top spot for new investments, up from Number 15 last year. "It's the beginning of a boom," says one interviewee. For existing investments, Dublin placed Number 2, just behind Munich and a big leap from Number 20 last year.

Ireland's economic turnaround is gathering pace. Unemployment has fallen to its lowest level since 2009, and the government is forecasting GDP growth of 2 percent in 2014.

Significantly, the IPO of Ireland's first-ever REIT – Green REIT – raised €300 million last August; the issue was oversubscribed. A second REIT also floated at the end of 2013, raising €365 million from investors. Both are targeting commercial properties, primarily in Dublin.

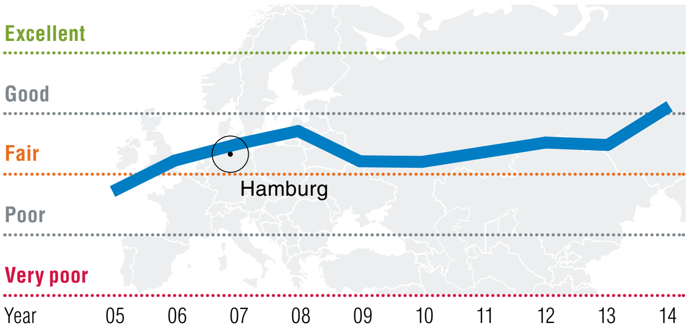
"Purchasers in the Irish property market have huge amounts of equity at the moment," says an interviewee. Office prices have increased significantly over the past 12–18 months in prime locations such as the docklands, and locals are predicting a further rise of 10 percent in 2014. US and other foreign buyers have been at the forefront.

Plus, banks have started lending again, but debt is still "very much limited", available "only on the right assets to the right principal".

The residential market is also recovering, with prices for well-located properties rising over 20 percent last year. But retail is still under pressure, with rents continuing to fall, albeit at a slower pace.

Hamburg (3)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Hamburg is another big German winner. The port has skipped a couple of places up the rankings and is in the top three for investment prospects.

The city's diversified economic base helps sustain a steady level of office demand; in addition to transport-related industries, it is big in media and finance and has strong business links with China.

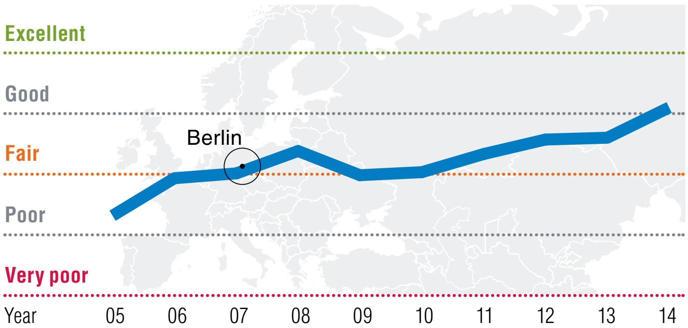
There is much competition for core offices, with yields around 4.7 percent. Domestic investors dominate, but there is an increasing element of international capital looking to get into the city. Residential, too, has considerable longer term momentum thanks to Hamburg's relatively high population growth, boosted by inward migration. Rents have risen an average of 5.7 percent annually since 2007, but have now started to plateau.

Retail in Hamburg has good underpinnings: a growing population with an above-average level of disposable income and lots of tourists who make 10.6 million hotel reservations annually. There has been little new development, so the supply of prime space is tight.

HafenCity, Hamburg's gigantic redevelopment of its former port is midway through creating an entirely new quarter that will double the population of the city centre. Due to be finished in 2025, it will also make Hamburg one of the most sustainable cities in Europe.

Berlin (4)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Germany's capital is as popular as ever with investors, and has moved up to Number 5 for development. The city's young population plus its growing influence as a European media and technology hub, makes it a hotspot.

"Berlin offers strong prospects in the residential sector." Rents in Berlin have been rising steadily, especially in recently modernised buildings. The sector has attracted international attention: "Residential investments in Germany's top locations are a must." And it's not only rents that are rising. House prices in certain areas of the city have doubled in the last year.

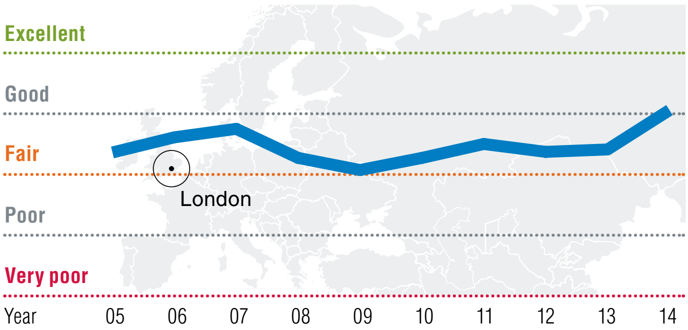
Berlin's housing boom has become a political issue, with all parties in last year's election indicating they would introduce stiffer caps on rent rises. It remains to be seen what form these will take.

That could have some switching to the office market, which is enjoying its own mini-boom. The city is on most core investors' hit lists. "Berlin is becoming interesting again. For a while tenant demand was government-led, but there is a real buzz about the city now. Its economy has become more diverse and so has the tenant base. Demand for office space will grow as companies hire more and more people because of the strong economic climate," says one interviewee.

Retail is also seeing good demand, with rents growing sharply in prime locations.

London (5)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

London is still a firm favourite with investors seeking core and core-plus assets, as it makes the most of its reputation as a safe haven for foreign investors. The city knocks Istanbul off the top spot for development, up from Number 5 last year. It remains among the top five in terms of investment.

"London is a global city that gives the opportunity to exploit the ups and downs of the market," says one interviewee.

Foreign investors are still prepared to write big cheques. "Large amounts of sovereign capital from Asia and Middle East are coming into London." Funding deals is also easy. "You'd be hard pressed to think of anything in central London that would be classified as un-fundable."

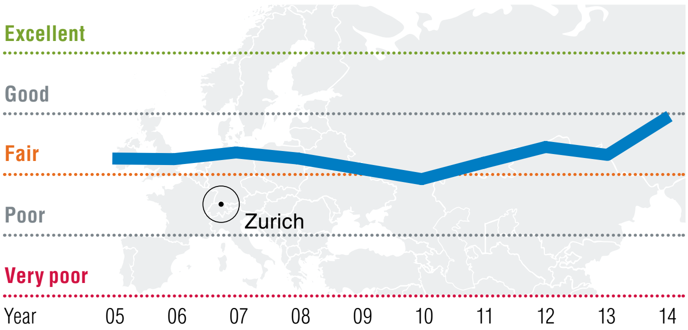
London's popularity with sovereign wealth funds and other big spenders has inflated prices, leading to concerns there's a bubble in the making. "The West End of London is scary, and there is still an expectation that prices will continue to increase. City of London prices will stabilise but at a price that is too high," says one interviewee.

Though vacancy rates may have dropped, the UK's economic recovery is fragile, though forecasts of 2 percent GDP growth for 2014 are encouraging. "London is fairly fully priced and now needs rental growth to deliver returns. Because of that, a lot of the UK institutions are going into the regions again." Investors are also putting money into strong secondary assets that they can turn into core.

Central London's buoyant prime residential market is also attracting significant interest. The sector has not been a mainstream one for institutional capital, but that is changing. Both UK and international investors are tentatively starting to develop and refurbish property, both for sale and rental.

Zurich (6)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Zurich remains in the top 10 for development and existing investments, but in a weaker position than last year. However, it has slipped down to Number 16 for new investments from Number 5 last year.

Nonethless, good quality prime assets remain in demand. "The top products will always sell very well, but rents are no longer growing." Indeed, the growing supply of new offices in Zurich has already started to depress rents.

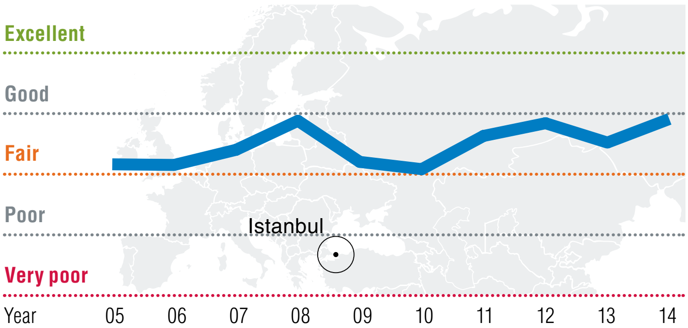
And although Switzerland has benefited from the European debt crisis because the Swiss franc has been regarded as a safe haven, foreign investors may find the price tags too expensive. "Prices in Switzerland are close to an all-time high," says one interviewee. There is also a perception that many international investors still consider Switzerland "a closed market".

Anecdotally, more international investors are said to be taking a closer look at Switzerland. However, domestic players such as pension funds, insurers and real estate funds dominate and will continue to invest in home-based assets rather than look for opportunities abroad. "Switzerland is expensive but that is still no reason for many to choose foreign investments." "In Switzerland the demand from Swiss investors for Swiss real estate is still big."

There is also some concern that the availability of domestic debt for Swiss real estate has been declining. "The three main lenders are currently decreasing their appetite to lend money to the real estate sector which is slightly worrisome." But compared to elsewhere in Europe, locals say the availability "still looks paradisiacal".

Istanbul (7)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

One of last year's darlings, Istanbul has dropped several places but remains in the top 10 for investment.

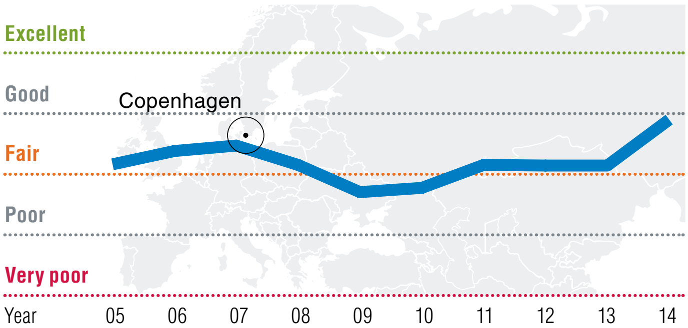
Investors generally like Istanbul because it is a high-growth market, backed by a strong economy. Turkey's demographics are also very appealing, with a young and rapidly growing population of 75 million. Retail is attractive because "affluence is developing" and "the middle class is establishing itself".

However, there is a lack of quality assets, which could put off many international investors. And, "in Turkey the valuations remain volatile and really depend on location and new developments". Plus, "prices are too high" and "political stability is considered an issue", according to one interviewee.

The government's 2012 decision to lift restrictions on foreign property ownership is attracting investors from Russia, the Middle East and Asia. Turkey's Association of Real Estate Investment Companies predicts foreign investors will put $US10 billion into the Turkish market over the coming years, especially as they will now receive the right to reside in Turkey, regardless of the amount invested.

Copenhagen (8)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Copenhagen's investment prospects have improved, siting it in the top 10 for 2014.

Denmark has Scandinavia's weakest economy, but is pulling out of recession; the government has said its 2014 budget will support growth and employment. Finance remains limited, and banks are unwilling to lend for the time being, which could have a negative impact on the market.

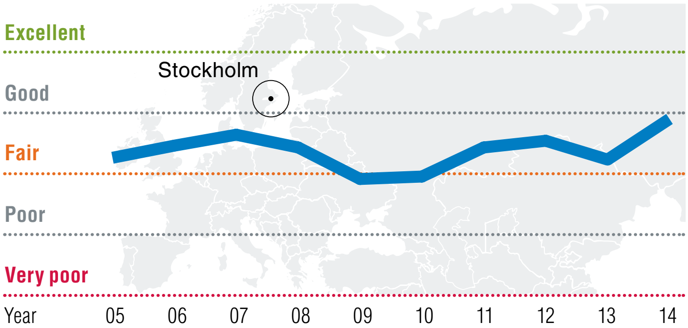
In Copenhagen's office market, vacancy rates and rents are stable with yields around 5.25 percent for prime locations, and investors are particularly interested in green buildings. "Copenhagen is far ahead with sustainability."

Strong population growth is boosting demand for housing, and Danes have access to record-low mortgage finance using short-term bonds.

Danish consumer spending is picking up, which offers good prospects for retail. However, the focus is on prime with secondary locations suffering.

Stockholm (9)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Stockholm is still in the top 10 for investments this year. Investors rate its strength and stability. "Stockholm has good growth, one of the best in Europe."

Domestic investors dominate, but international capital is going in via local funds, and the city is also on direct investors' target list; they rate its pulling power as the Nordic headquarters of choice for global firms.

However, the low yields on prime Stockholm CBD offices mean that some find it "difficult to see any upside". Prices are not expected to change significantly in 2014. "Stockholm is very expensive. Secondary markets are receiving more attention." The outskirts of the city offer "less completion and increasing tenant demand".

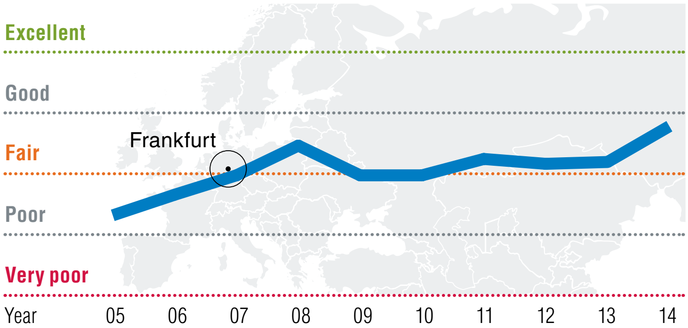
With risk appetite on the rise, some international investors may be inclined to look towards other markets in Europe, like Spain. "Everyone has been raving about Stockholm but I think all the growth has been priced in," says one.

Prices of secondary assets are expected to rise, especially if bank and other financing increases. The availability of debt for real estate has been improving, though the loan-to-value lenders are prepared to offer has been decreasing since 2009 and is expected to remain conservative.

Housing portfolios and residential development are also flagged as good bets. Stockholm's population is growing and "too little" housing is being built. However, concerns that a house price bubble is developing have led regulators to take measures to slow mortgage lending.

Frankfurt (10)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Frankfurt is again in the top 10 this year. Continental Europe's largest financial centre, the city is heavily dependent on banking and other finance-related industries.

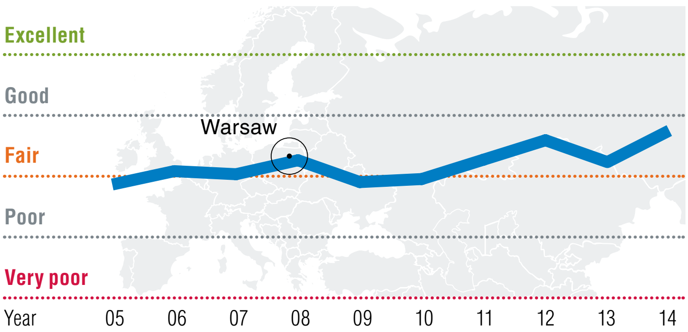
With the end of the eurozone recession, demand from financial services is picking up. Office take-up has risen and prime rents are holding steady. The vacancy rate is dropping, not only because of good occupational demand, but also because obsolete offices are being converted to other uses, such as budget hotels or residential.

Core investors, beguiled by the strength and liquidity of the main German markets, have Frankfurt on their shopping list. The weight of money – national and international – is pressing on prime yields.

Along with Berlin, Frankfurt is thought to offer the best prospects for residential investors in Germany. The city's population is expanding, but supply has not kept pace. To encourage new building, the city has been subsidising the development of apartments for rent and there are big mixed-use urban regeneration projects on disused city centre sites, such as Europaviertel.

Warsaw (11)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Poland's strong and steady economy makes Warsaw a favourite Eastern European real estate market, but interviewees say it is now beginning to resemble Western Europe and may offer lower growth than before.

The city has slipped down the rankings in terms of new investments and developments, but remains strong for existing investments.

"The Polish market has matured in the past two to three years. There was a niche in the early 90s with very easy sites to develop. They were clearly excellent sites and it was a no-brainer. Sites now need to be thought through."

With Poland being regarded more and more as an established core European market, yields in Warsaw have fallen. But the country's hitherto rapid economic growth is slowing, and there is a big supply of offices in the pipeline. "Over the next 12 months, better prospects are expected to be offered by second tier cities in Poland, such as Wroclaw, Krakow."

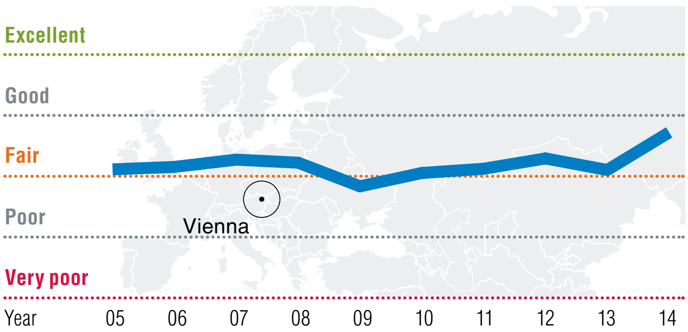
But Warsaw will continue to attract investors because of its proximity to Germany and because it is the biggest consumer market within central Europe, with 40 million consumers. "Poland is an extension of the eurozone."

The logistics sector is popular, while retail is being boosted by refurbishments of existing shopping centres.

As a result, Warsaw remains a magnet for foreign investment, especially from new players. "We even have countries like Azerbaijan interested in the Polish market. We have also seen Korean pension funds. This is new money. They see Europe as a safe haven."

Vienna (12)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Vienna is pretty much stable in its investment rankings, but has risen to Number 10 for development. The city is gaining popularity because many like the way it is dealing with environmental and demographic changes.

They say it is one of the European cities that are best adapting its urban plans to make itself more liveable. "Vienna is a great example of somewhere that is grappling with this."

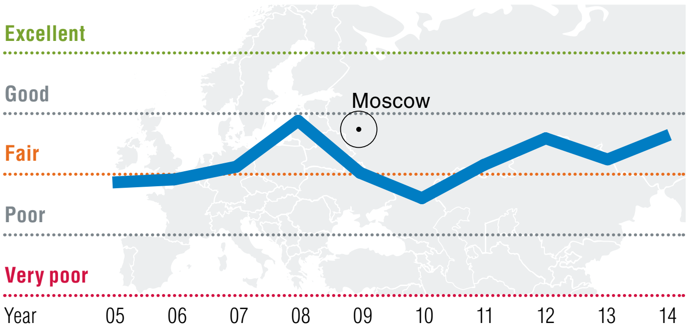
The city is building the Golden Quarter, a new pedestrian shopping area, which will include a five-star Park Hyatt hotel, luxury apartments and high-class fashion stores such as Louis Vuitton. Locals say the area is attracting interest from equity-rich Russian investors, who want to snap up historic buildings on offer.

Construction will finish in 2014 and will offer great prospects for retail in the city, already one of the best European markets. "Rents are stable or even increasing; demand exceeds supply. Also, international retailers want to benefit from Viennese shopping tourism."

In the residential sector, luxury properties will continue increasing in price, but in other parts of the market prices are expected to remain stable.

Moscow (13)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Moscow has jumped in the rankings to Number 4 for development, but has slid out of the top 10 for investment.

"Moscow offers the best prospects for opportunistic investors. People are getting over the political situation."

Debt is "readily available" for development projects, with Russian banks offering significantly better loan to values than foreign ones. And domestic equity is "abundant"; real estate is "one of the few sectors free of government interference".

Office prices and rents are expected to remain stable in 2014. "There is little new demand so that does not create a super environment for property prices in the office market."

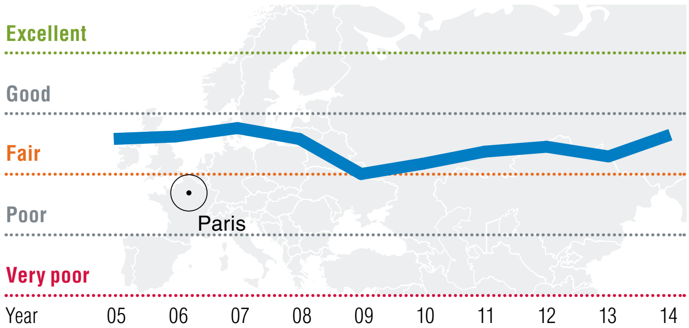
"Russian retail has been the prime beneficiary in the growth of consumer spending," says one local interviewee. Last summer, Hines CalPERS Russia Long Term Hold Fund took a 40 percent stake in Moscow's premier Metropolis mall, a move that "will likely help other private equity funds or sovereign wealth funds sit up and look at Russia more seriously," locals say.

They are also extremely bullish on Moscow residential. "Many players are shifting from office to residential because of the prospects of increased returns."

Some international investors, however, are more sceptical about Russia's "extremely volatile" market, terming it "almost a no-go area because investors don't have the scale or they are scared – many people have lost their shirts". "We have a love affair and a hate affair with Russia," says one interviewee.

Paris (14)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Paris has been thrown out of the top 10 rankings this year, amid concerns about the political situation, high taxation, persistently high unemployment and France's huge debt pile.

President François Hollande's low approval ratings, coupled with strikes, growing social tensions and a generally gloomy mood in France, are also not helping the city's image.

But institutional investors still view it as one of the crown jewels in their portfolio, even if they are more lukewarm about its prospects in 2014. "You must 'have' Paris but at the moment it's not ideal." "The underlying fundamentals in Paris may be wobbly but we take that into account."

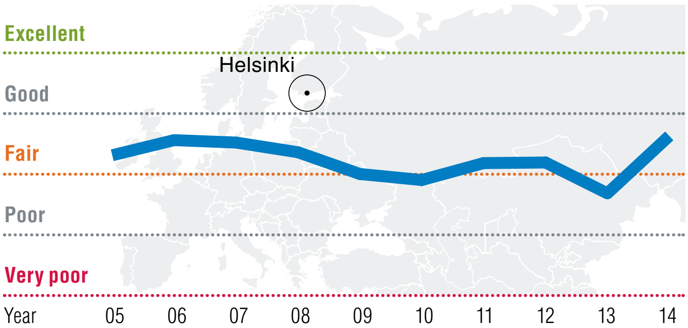
The city's must-have status makes it a firm favourite with Asian and Middle Eastern investors. More of their capital will be flowing into trophy assets in 2014.

The heavyweight investors still favour core and core-plus offices in central Paris and are cherry-picking in key areas such as the 8th arrondissement. But the high price tags are leading some to eye other locations. "Investors are beginning to see that the first and parts of the second rings surrounding the heart of Paris can be lucrative."

On the outskirts of the city, concerns about oversupply in areas such as La Défense are playing on investors' nerves. There is an estimated 400,000 square metres of offices due to come on line in early 2014, while many companies are moving out west to cheaper suburbs. "It is a very volatile market in La Défense. You can make a lot of money but you can lose a lot of money."

Helsinki (15)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Helsinki is not one of the best performers in the rankings, but it wins points for its forward planning. The city has bought up swathes of farmland to the east to cope with inward migration from smaller cities.

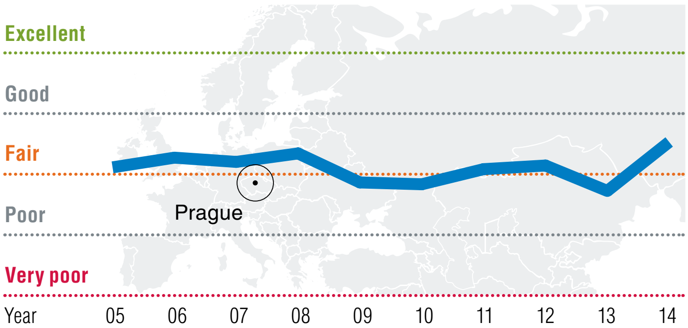
This inflow is fuelling housing demand, and residential has been the best-performing sector for several years; Finnish institutions have increased their allocations to it and several residential property funds are active.

Finland's economy slid back into recession in 2013, as demand for its exports dropped, and the government has cut its growth forecast for 2014. Helsinki's office market has been quiet but stable, as occupational demand has held up.

The retail sector, however, will likely suffer from lower consumer spending on concerns about the economy. Funding for deals, too, is becoming an issue. "Transactions are currently more dependent on the availability of funding than on property prices."

Prague (16)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Prague stays in the middle third of the European league. "I am much more bullish about our prospects than I have been in recent years" says one interviewee, reflecting the more general optimism about the city's prospects in 2014.

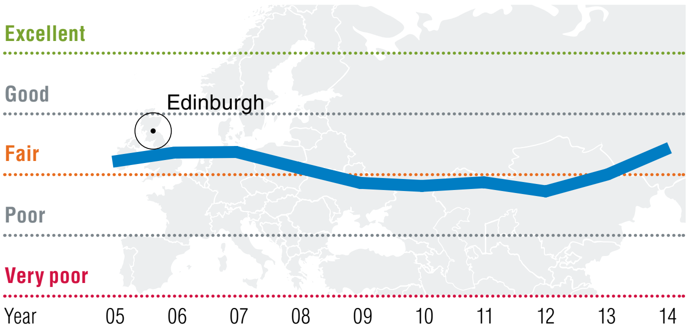
Interviewees say it's one of the most interesting markets in Central & Eastern Europe after Warsaw. But the Czech economy, which started pulling out of its recession in early 2013, stuttered towards the end of the year.

No one is expecting a big real estate bang, but rather, prices remaining more or less stable in Prague and throughout the Czech Republic. Residential development is also reckoned to provide good opportunities, as ultra-low mortgage rates of around 3 percent have fuelled Prague's homebuyers.

Rents on prime CBD offices have been stable since 2009, and prime yields have hardened slightly. Further improvement is expected in 2014, as the market gains liquidity. Retail is also expected to fare well in 2014. There are new shopping centres and extensions under way and Prague's Na Příkopě is the most expensive shopping street in Central Europe.

Regional centres:
Edinburgh (17)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

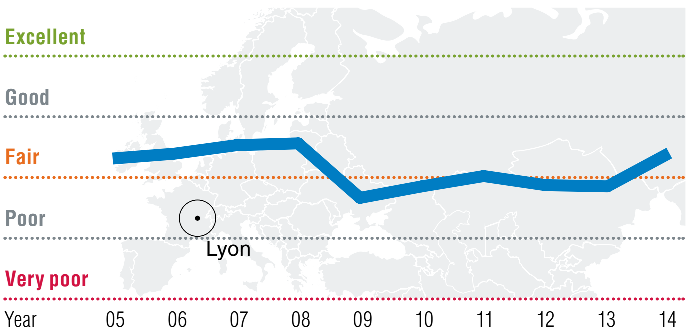
The big question in 2014 for Edinburgh will be Scotland's independence referendum and what impact it will have on real estate investment in the city.

Locals say that Edinburgh's position as a key European financial centre make it a safe bet, even if Scotland votes in favour of independence, and at Number 17 for existing investments and Number 15 for new ones, the city has remained around the same place in the rankings as a year ago.

Interviewees note there is growing interest from institutional investors in the city, particularly those who are trying to get away from high prices in London. More deals are expected in 2014, as signalled by fund manager Moorfield's purchase late last year of Quartermile, one of Scotland's largest urban regeneration schemes on the site of the city's former Royal Infirmary.

Lyon (18)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

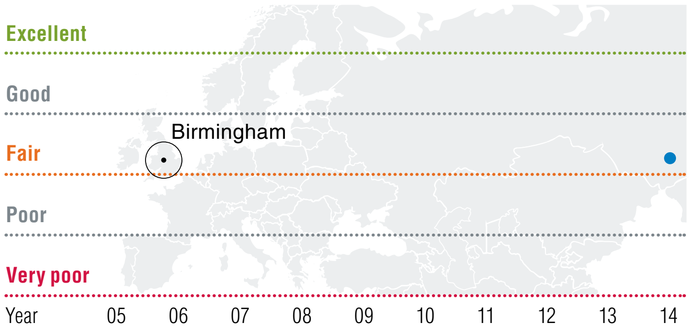
Lyon, France's second business capital, is beginning to register with those canvassed by *Emerging Trends Europe*.

Interviewees highlighted it for logistics; Lyon is at the crossroads of highways linking it to Paris and other major centres. The city's diverse economic base underpins the market; it is a centre for chemical, pharamceutical and biotech industries and has a burgeoning software sector.

Investment activity rose substantially last year, dominated by office deals, with French buyers – REITs and insurance companies – outbidding foreign ones. With both international and French buyers vying for deals, prime yields, which are attractive compared to Paris's, are coming under pressure.

Birmingham (20)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Birmingham is a newcomer to *Emerging Trends Europe*, entering the rankings for the first time this year. The UK's second-largest city is Number 20 for existing investments, Number 22 for new ones and Number 19 for development.

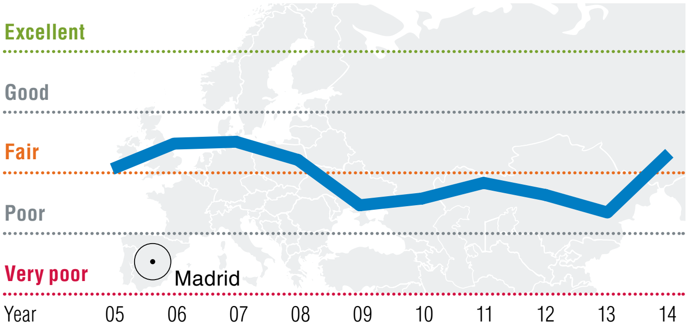
However, the high prices of core office assets in London is encouraging investors to look to the regions, and one of their favourite destinations is Birmingham. This is particularly true of UK institutions, which cannot swallow the low yields and large lot sizes that cash-rich sovereign wealth funds and private buyers are prepared to take for prime London offices. "We are a big player in Birmingham," says an interviewee.

A smattering of foreign money is also interested in the city, "If I was sitting on a lot of cash, I would go for secondary cities in the UK like Birmingham," says an international investor.

However, for some international money, "the lot sizes on offer are generally not big enough and there are few opportunities".

Spain:
Madrid (19)

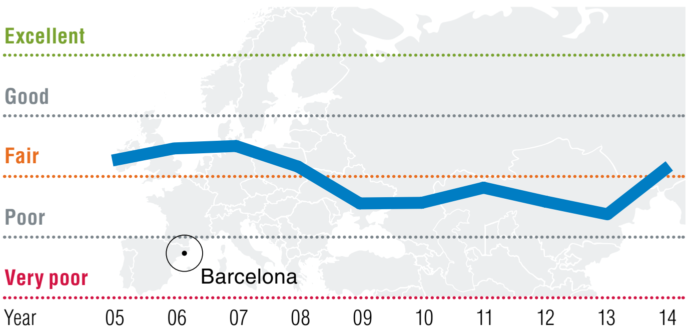
Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Barcelona (22)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Spain is back in business. That's the message – loud and clear – from those canvassed by *Emerging Trends Europe*. "Everybody got off their beach towels in August and decided Madrid and Barcelona are where it's at."

Madrid has jumped to Number 10 for new investments with more capital expected to arrive in 2014. "Prices are reaching bottom, and the upside is coming. It's a big market and is the capital of a country with 40 million people." Barcelona is not far behind at Number 14.

Though office rents and vacancy levels in Spain's capital are not yet improving, yields may tighten slightly due to the weight of increasing investment demand. "Office properties in Madrid with government tenants look like a good choice." Barcelona has strong prospects in the hotel sector. And, as Spain recovers from recession, there's growing interest in shopping centres and prime high streets.

On the supply side, Spain's bad bank, Sareb, has some €50 billion of toxic real estate assets to shift. The pace of sales – non-performing loan portfolios and residential properties – is picking up. "If I was an opportunistic fund, I would enter the Spanish market and could take the risk of making a bad investment," says one interviewee.

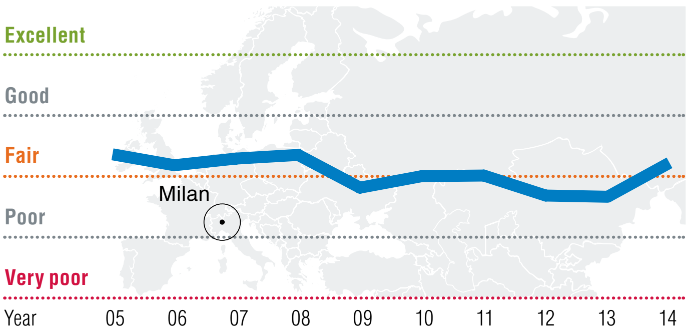
The huge supply of residential property is also attracting foreign capital. US opportunity fund Blackstone and Goldman Sachs were early movers, snapping up housing sold by Madrid's city and regional governments last year. Russian investors and funds are also eyeing unsold developments in southern Spain, which could be of big interest to tourists.

But the real challenge for anyone willing to enter the Spanish market will be how they intend to fund deals, as banks remain jittery about lending. "There are opportunities mainly in Madrid, Valencia and Barcelona. But you won't get financing so you need equity."

And not every investor wants to put their money into Spain. Some interviewees say that while the country is definitely back on the radar screen, they remain cautious about prospects.

Italy:
Milan (21)

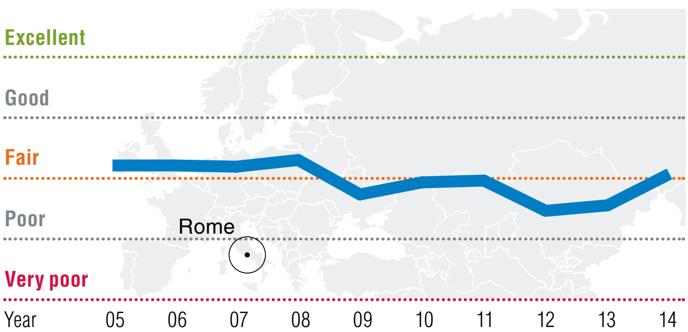
Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Rome (24)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Milan and Rome are continuing to languish in the bottom half of the table as the political and economic situation in Italy weighs on investors' minds. "The Italian market is not attractive due to politics. This has caused Italian property prices to go down." Although many investors remain wary, some interviewees are more optimistic. "The perception of Italy is that country risk and asking prices are decreasing." "In Italy there is product and there are opportunities: prices seem to have reached the right level."

They are predicting that 2014 might be the year markets such as Milan return to favour. It is gearing up to be the host of Expo 2015, which will raise the city's profile. "We have seen Milan as the top location (thanks to the 2015 expo effect), mostly in the office sub-sector."

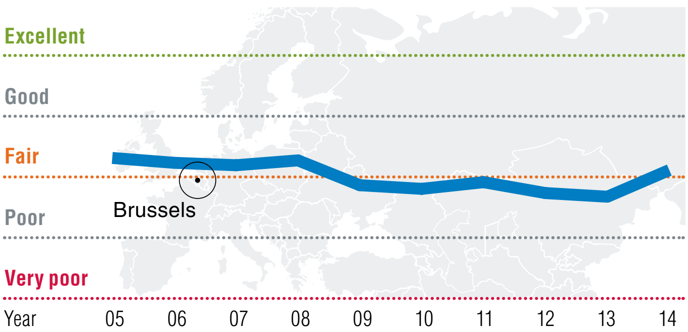
The city's offices are attracting both core and opportunistic investors seeking alternatives to the increasingly expensive European hotspots of London, Paris and main German cities: "We will see more interest from international investors who want to diversity." Last spring, Qatar's sovereign wealth fund bought 40% of Hines' Porta Nuova business district development in a deal worth €2 billion. Shopping centres, too, are being targeted.

The Italian state is seeking to sell off properties and many Italian office buildings need refurbishing, which could provide opportunities. However, locals say assets that would attract large, cash-rich investors are few and far between. "The sovereign funds in Italy looking for trophy assets only, do not really influence the market, because there is not enough product for rich investors here in Italy."

As the political centre of Italy, Rome will fare worse than its northern cousin; there is little demand in its office sector. Retail is a different story. Although consumer spending is still heading south, Italians are not as heavily indebted as some other European households, and luxury retailers are bucking the trend. Demand is focusing on the top locations and centres; prime rents here remain relatively stable. "We see opportunities in Rome and Milan as there is still undersupply in the market."

Brussels (23)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Brussels may benefit from its status as a smaller city that is also a major political capital. "Investors that are starting out may not want to invest in larger, more expensive cities and may want to look at cheaper options such as Milan or Brussels," says one interviewee.

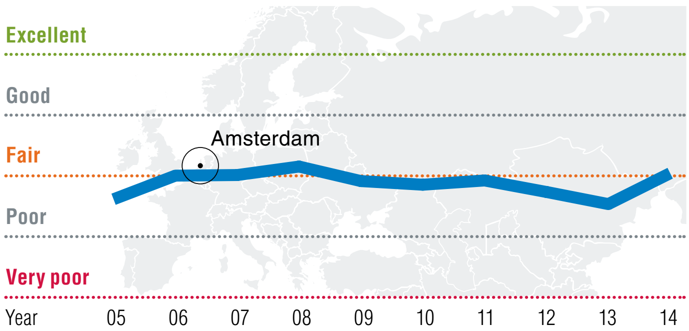
But for the city's office sector, "the outlook is negative" with vacancy rates stubbornly high at just under 11 percent, and very little new occupier demand; European institutions have not been very active. Although some big financial groups like AXA Belgium are renting large offices, take-up was extremely weak in 2013, running at some 30 percent below its ten-year average.

Rents and yields are expected to stay the same in 2014. Some interviewees say they prefer to avoid the Belgian market altogether "because it is so easy to build that no rental increase is expected".

However, the retail market is showing signs of picking up as consumers start spending again, and prices are rising for logistics in prime locations.

Amsterdam (25)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Though Amsterdam's prospects for new investments have risen this year, it remains in the bottom half of the league. "The Netherlands is depressed – prices are on the floor. I expect the market to bottom out or slightly improve in 2014," says an interviewee.

Lack of capital, oversupply and a weak economy are weighing on the market. "The Netherlands should still be regarded with suspicion although there are some good opportunities. There are properties at really good locations (city centre of Amsterdam, Rotterdam) available at good prices."

Amsterdam's office sector, bedevilled by an 18 percent vacancy rate and low returns, is reckoned to have hit bottom. Interviewees think it will attract both core and opportunistic capital. "Foreign investors are starting to be afraid to miss opportunities in the Netherlands. Particularly, well-located offices are scarce." Prime rents have remained stable.

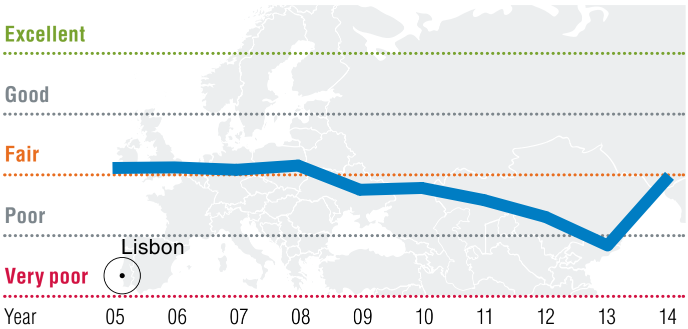
But retail is "very difficult", suffering from weak consumer demand and fast-growing internet sales, which are expected to depress values going forward. "High street retail is suffering badly with many empty shops."

The residential market has also bottomed out and over the longer term, demographic changes mean the population of Amsterdam will rise, boosting demand for housing. "In the next 12 months in the western part of the country and the biggest metropolitan areas such as Amsterdam, Utrecht and The Hague we are going to see interest from national and international investors."

With more foreign tourists visiting Amsterdam, the demand for hotels is increasing. And since 2007, the local authorities have actively been encouraging the growth of the hotel sector in the city.

Lisbon (26)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Lisbon is showing signs of picking up. "We all see the market changing for the better. People are now talking to each other."

Germany's Deka Immobilien's decision to buy an office block in Lisbon's Park of Nations, the largest real estate deal in four years and the first institutional buy since 2008, has sparked hopes of further deals in the Portuguese capital.

The city remains towards the bottom of *Emerging Trends Europe*'s investment rankings and has a lot of catching up to do. Portugal's recovery is not expected to be as rapid as Spain's, which is a much bigger and more international market. "Portugal is also upcoming but not that stable and much less interesting than Spain."

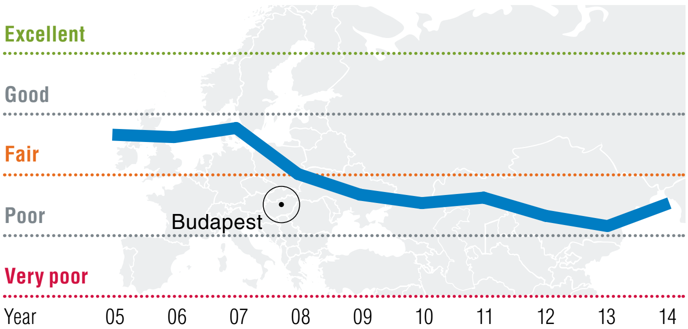
The country's economic situation will clearly be key in 2014, with investors watching out to see if Portugal manages to keep to the terms of its bailout agreement. Domestic demand for real estate is weak and "among national investors, there is a big pressure to divest", says one interviewee. "As for international investors, they are starting to show up."

Indeed, Lisbon gets a sprinkling of mentions among those interviewed as an opportunistic play for offices. "There is more interest in prime. And prices will increase more. There is little interest in secondary and it will fall further."

The Portuguese government's decision to award "golden visas" – i.e. resident status – for people who buy a property for more than €500,000 may also encourage an influx of Brazilian and Chinese investors.

Budapest (27)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Budapest languishes near the bottom of the pack for 2014, falling slightly from last year. "The general conditions in Hungary do not enable investors to do reasonable business," says one interviewee.

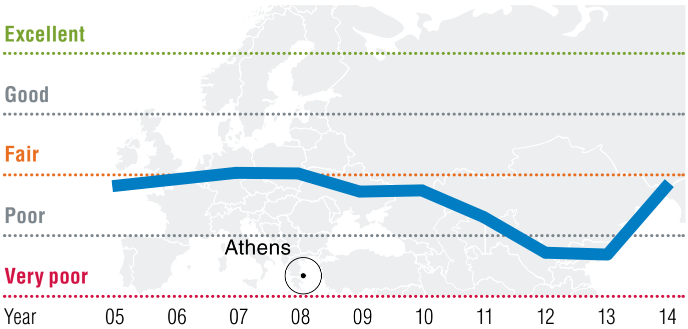
The uncertain political situation in Hungary is cited as one reason for avoiding the city; the European Central Bank has repeatedly warned Hungary's centre-right government not to interfere with the work of its central bank. The country's economy is also suffering from being one of the most indebted in Europe, but GDP growth has picked up.

Elections in 2014 may change things, but the ruling party's re-election could leave the country in the same position as before.

However, a handful of interviewees see an opportunistic play in Budapest. "There are great buying opportunities," says one who is doing their first investment deal there for two years.

Athens (28)

Investment prospects 2014



Source: *Emerging Trends Europe* survey 2014

Athens may have zoomed ahead in the rankings for new investments, but it's a market that most are putting "in the too difficult pile".

"Due to the negative perception of the Greek economy, Athens is a market which investors probably would not enter," says one interviewee.

The city continues at the bottom of the prospects for development and existing investments, even though its scores are better than last year's, indicating that respondents believe prospects are improving in 2014. Both international and local players are put off because of the difficult economic situation – even if Greece has managed to stay in the eurozone and has engaged on a tough austerity programme to help turn its economy around. "Greece is a no-go area," says an international fund manager.

Systemically important Greek banks have been saved by bailout funds, and debt is very limited, so potential deals are very difficult to finance.

Some may be attracted by 'bottom fishing' if the Greek economy shows signs of turning the corner. One early signal is Canadian group Fairfax Financial's acquisition of a stake in the Eurobank Properties REIC in 2013; the listed property company was majority owned by Eurobank, Greece's third-largest lender. Another significant deal is Invel Real Estate Partners' purchase of a 66 percent stake in the National Bank of Greece's real estate unit, Pangaia REIC for €653 million at year-end 2013.

And despite Greece's austerity programme, there are ambitious plans to regenerate parts of the capital. 'Rethink Athens' envisages a major overhaul of the city centre, turning it into a "green network", while the Hellenic Republic Asset Development Fund is seeking an investor to take on the transformation of Athens' former airport.

Green futures

Three years ago, sustainability made its way into *Emerging Trends Europe* as a brief footnote, as most interviewees dismissed its economic function. But between then and now, the industry has come a long way.

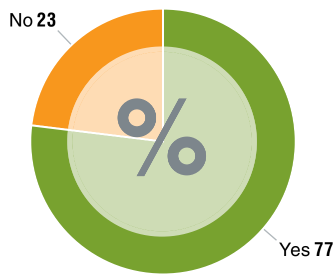
50%
get higher rents for sustainable buildings.

Today, over three-quarters of respondents have a sustainability strategy. "The crisis forced us to reinvent ourselves. Now we're making a tangible business case out of green property."

Very few respondents – 12 percent – say that sustainability will not be impacting their business this year. And interestingly, the countries where a relatively large proportion of respondents indicated that it would have a low effect included the UK, Germany, Switzerland and the Netherlands – all markets in which sustainability is not a new development.

In the post-crisis marketplace, it has rapidly evolved into a business opportunity. From a strategy that once manifested in a spattering of investment vehicles, sustainability is now diffusing into the culture of real estate.

Figure 1 **Sustainability in business strategy**



Source: *Emerging Trends Europe* survey 2014

Cynics say there's no hard proof of 'green alpha' – that green initiatives create enhanced capital values and income – and await it before they take the sustainable route.

But those surveyed by *Emerging Trends Europe* beg to differ: half claim they achieve higher rents for their green buildings.

There are other motivations too. Whether it's meeting the EU's green regulatory agenda, de-risking assets for anxious institutions, or attracting occupiers looking to matchmake bricks and mortar with green CSR policies, the pursuit of sustainable real estate is multi-defensive.

As one interviewee said: "For a few percentage points more on the costs on construction, you have a product which actually appeals."

Sustainable assets simply make good business sense. Sheltered from obsolescence, high operational costs and 'brown' discounts, developing green buildings is really about "developing quality buildings". "The greatest risk for us is long void periods, therefore non-green assets make no sense."

Today, employees of all pay grades are expected to engage with a firm's green objectives; it's no longer the sole domain of a lonely sustainability manager. Viewed as a tool to deliver good development, investment and management, staff, contractors and agents are expected to embrace green thinking.

Not least, it's paramount to building a modern property brand, with more and more of a company's website dedicated to outlining its green and social credentials. "Absence of a green strategy today is odd, as odd as a retailer that doesn't have an internet strategy."

Sustainability 2.0

Today, pursuit of operational efficiency is a goal for many. Interviewees report taking a forensic interest in how a building performs in occupation to ensure its carbon footprint remains slim.

Not so long ago, BREEAM, LEED or HQE certificates confirmed a building's green credentials. But regulatory threats now mean certificates are not enough:

"Operational ratings will overtake certification in the future. It's not just about having the right asset."

Investment in efficient supply chains, technology and management systems are driving measurement of operational performance.

The objectives of green policies are also maturing. In the Netherlands and France, the industry is exploring how buildings can ensure a pay-off for the environment.

'Cradle to Cradle' certification is one popular methodology in the Netherlands. "Everybody thinks about how to use less energy. At best, that approach makes you less bad. But we want to create positive footprints with our buildings."

Many now also believe the best solutions for sustainability should be negotiated at the district level. Expect industry to collaborate with policymakers. "Energy targets are more achievable at an urban level. You can get one building doing well but there may be ten around it that aren't perfect."

'Social' sustainability is a top objective for those with established green policies in 2014, especially for long-term owners of assets. Interviewees want buildings that impact the surrounding community positively – often referred to as a "social return on investment".

Initiatives range from providing electric car recharge points, to green amenity spaces on-site and bee hives in retail parks. Firms are also committing to hire local labour and offer apprenticeships.

Placemaking, a trend influenced by successful schemes like London's Kings Cross, is gaining in sophistication as the industry looks at creative ways to ensure viability: "The long-term sustainability of schemes is about the curation of a better tenant mix, not just leasing to the high street retailers that can pay the best rents."

Interviewees are therefore thinking through the implications of leasing a unit to a multinational coffee chain. As one said: "It might not help attract the modern office occupier to a mixed-use scheme." The economics of having less profitable 'independent' tenants is being explored. "Developers are considering the value of loss leaders."

We wouldn't look at an asset without looking at its green footprint.

The future's really green.

Regulation sticks

Regulation is a key driver, increasing sophistication in sustainability.

From the *Energy Roadmap 2050* to its 20/20/20 greenhouse gas targets, the European Union has an ambitious green vision.

And since buildings account for 40 percent of the EU's energy usage, the real estate industry is being called on to help deliver them. "Policy is a very noisy space right now, and there's a lot of confusion." "Green regulation is only going to intensify."

Key policies include:

- The strategies introduced to mobilise green investment in existing buildings by countries seeking to comply with the EU's Energy Efficiency Directive.
- Europe's Energy Performance of Buildings Directive, which is driving for nearly zero-energy buildings by 2020.
- In France, Grenelle laws 1 and 2 – which require all new buildings to produce more energy than they consume – impact development as the 2020 deadline approaches.
- In the UK, amended building regulations requiring new homes to be 6 percent more energy efficient and commercial buildings, 9 percent more, starting in April 2014.

Institutional kicks

European institutional investors see firms with no green strategy as an investment risk.

A sustainable strategy is now "part of the definition of fiduciary duty", "shows you're a robust business with a future" and "demonstrates you understand risk management".

One interviewee was given a significant real estate mandate by a large pension fund on the strength of its green initiatives. "There's a lot of capital out there but it is differentiating between companies. Green policies are just another basis of differentiation."

Investment consultants ask more questions in 'ever-increasing' detail as they look for evidence about what's been achieved. "Any company looking for third party capital today needs to understand what they're doing in terms of sustainability." Reporting guidelines from organisations such as EPRA and INREV, as well as investor toolkits from the Institutional Investors Group on Climate Change, are adding pressure.

Plus, the Global Real Estate Sustainability Benchmark (GRESB), which rates policies and their execution, is increasingly influential. It provides a method of assessing the sustainability of existing assets and new purchases, and allows investors to compare performance.

Some institutions make participation in the survey mandatory. "Institutional investors are the [driving force] behind GRESB. If they weren't worried about climate change risk, they wouldn't be doing that."

Lenders lag

In contrast, many lenders' attitudes towards sustainability are still at best "disinterested". As one said: "I haven't seen banks contributing much to this debate so far."

However, some financing initiatives for green policies are emerging. German banks are incorporating the sustainability of commercial properties into their mortgage terms, while Swiss interviewees report securing better mortgage terms for green refurbishment projects.

And Germany's state-backed KfW Bankengruppe has made €8.9 billion available through 'soft' loans or grants to promote energy-efficient investments for new and existing buildings.

Insurers and other institutions entering the real estate debt markets may also bring a keener green focus. "We'll apply responsible investing to our funds whether we are lending or buying direct," says one.

Operation and occupation

Despite lack of hard data on 'green alpha', half of those surveyed by *Emerging Trends Europe* say they had achieved higher rents for sustainable buildings.

"We just exited a green asset where we'd achieved an IRR of 24 percent – a 10 percent premium on the IPD benchmark for a comparable asset."

The other half believes it's near-impossible to identify the impact of green features within a generic uplift in a building's value and income. "It is akin to estimating how much a lift contributes to performance, it's just not realistic."

Regardless, innovation is under way. Large corporates are now including minimum sustainable and energy certification levels for buildings they wish to occupy, while leading developers and landlords are moving a step ahead.

Driven by the supersonic rise in energy costs, firms are working on measuring water, gas, electricity and waste to help tenants manage utilities and service charge costs.

"Over the next five years, energy bills will double. We tell prospective occupiers how much they're saving per square foot compared to the building they're in."

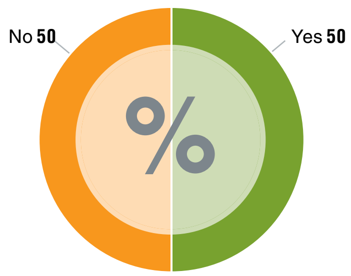
As one large corporate occupier says: "Saving millions across our portfolio through operational energy efficiencies impacts our profit and loss. Today having that capability is crucial to whether we rent a building or not."

But opinion is divided over whether money saved on bills will be paid in extra rent, as summarised by two interviewees:

"Inevitably this will translate into the rental growth prospects. But it hasn't manifested yet."

"The market will eventually expect to see a property perform in a certain way and to certain standards. People won't pay extra for that, they'll just pay less for real estate which doesn't comply."

Figure 2 **Do you achieve higher rents in sustainable buildings?**



Source: *Emerging Trends Europe* survey 2014

Management matters

Whatever the outcome in rents, sustainable day-to-day management is becoming part of a landlord's duty in 2014; green lease clauses and memorandums of understanding are gaining in popularity.

But it is widely recognised that they rarely establish green behaviour in occupation. "It's not just about having the right asset or a green lease clause. It is about how you operate it, and about having an engaged tenant."

Having detailed sustainability plans and targets for buildings are therefore key objectives for asset managers, especially as the European Union seeks to regulate operational efficiencies in pursuit of ambitious CO2 reduction goals. "We don't put windmills on a roof. We focus on management, measurement and behavioural change," says an interviewee.

Savvy landlords will foster dialogue with tenants, working together to improve efficiencies. Initiatives include data-sharing, quarterly sustainability meetings and manuals to educate tenants about lowering energy usage. Some are funding upgrades, whereby both parties agree to share in the savings made. "It can sometimes be the difference between signing a lease or not," says one.

Green investing

Investors are setting minimum standards when buying buildings, as energy retrofits feature more and more in regulatory requirements. Reports from France, Germany and the UK suggest low energy certificate ratings have been used to reduce transaction prices in recent months. Expect more of this in 2014.

These standards are being pushed by institutions, which require that assets purchased should meet responsible 'ESG' principles – minimum environmental, social and governance standards. As one says: "If we can't bring an asset up to our minimum standard, we don't buy it."

Regulations are driving many to refurbish existing properties to bring them up to standard ahead of future targets, mitigating depreciation risk and spreading refurbishment costs over a number of years.

And existing portfolios are being reviewed to see what needs to be done to bring assets in line with forthcoming legislation, such as the performance certificates and near-zero carbon initiatives being introduced in the UK. Valuation tools such as IPD's EcoPAS – due to roll out from the UK to France in 2014 – will further support this process.

Some will seek to capitalise on this with dedicated retrofitting funds: "Repositioning assets from brown to green is a massive opportunity for someone."

And, according to interviewees, sustainable construction is getting cheaper. "If the sceptics perceive it costs 8 percent more to build green, it is actually more like 4 percent."

Lower costs are especially achievable if sustainable features are planned at the outset. Savings are also being found in the supply chain and through better control of the construction process. "We are now talking to suppliers and monitoring what happens at every stage of the build process and understanding what materials they are sourcing, and from where. We've lowered construction costs of green buildings by 25 percent."

Figure 3 **Reasons for investing in sustainable assets**

Source: *Emerging Trends Europe* survey 2014

Smart cities

Climate change, resource availability and demographic pressure are emerging concerns for many leading CEOs in 2014.

"Investors can't just focus on the environment; we need to think about the future comprehensively – about mobility, planning, quality of life."

Several European property organisations are already exploring how both industry and policymakers can make cities more liveable in the future. "Cities that address these issues now will be more competitive in the future, as they'll be able to attract and retain the best talent."

And real estate players are considering what this means for their investments today: "Planners will be able to see where transport and buildings should be located to maximise their efficiency and minimise impact; that will have an impact of where offices, homes and schools are positioned in the future."

Expect cities and developers to innovate in this field. New York City is setting an example, with 'Plan NYC' using green thinking to prepare the city for one million more residents and climate change.

In Europe, 'Smart City Vienna' looks to reduce carbon emissions and improve mobility and resource use, while Paris has built on the success of its bike-sharing programme and has 105,000 registered users of its electric car-share scheme. Further south, Barcelona has electric-car charging stations and initiatives with solar water heating for large buildings.

Munich, Stockholm, Amsterdam, London, Berlin and Frankfurt also have smart city projects of their own.

Smart design

Human-centered design, such as providing bike racks or installing staircases rather than lifts to promote active lifestyles, is also gathering momentum. Some developers are building their brands around it.

"There's now a huge amount of scientific evidence that better buildings lead to better productivity. We are using this as an opportunity and communicating that knowledge to prospective occupiers," says a developer.

For tenants, productive, healthier workspaces can mitigate costs caused by sick leave and staff turnover.

In this new approach, office buildings are designed with a new generation of workers in mind. "New economy" employees want holistic, lively environments in which to work and play.

But it's not just about TMT – technology, media and telecommunications occupants like Google. "It's about talent attraction, a new generation. Developers need to get much cleverer to capture them."

"We get the internet up and running as part of finishing the building, occupiers want to plug in and play." "People expect amenity space and opportunities for recreation like terraces or pocket parks, as well as healthy environments."

In London and Amsterdam, new developments provide living quarters with workspaces for entrepreneurs in the basement. Others are designing residential schemes around the idea of the 'shared economy': homes with common laundry services and parking spaces for shared cars.

But the very TMT firms driving leasing markets are shaping real estate in a more fundamental fashion. Interviewees are tracking the development of the first 3D-printed house being developed in Amsterdam. "It's not science fiction, it exists," as one says. "We anticipate being able to print parts of our own stores in the future," says another.

And some entrepreneurial firms, driven by their success with online consumer experience platforms, are thought to be looking at launching platforms that allow occupiers to rate their experiences of a building. As one says: "A Trip Advisor for commercial property could happen. Why not?"

Green is grown-up

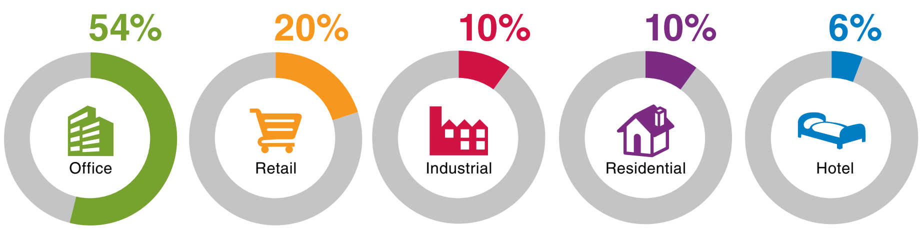
Last year, the key message from *Emerging Trends Europe* was "sustainability matters". This year, sustainability is a fully grown-up topic, as leading CEOs explore the many ways that it can be employed to competitive advantage.

Green strategies will become an ever more essential part of fiduciary duty. And as regulation, rising energy costs and occupants drive the demand for operational efficiencies in buildings, it will become increasingly impossible to approach sustainability as an unsophisticated box-ticking exercise.

In 2014, evidence of 'green alpha' may become more apparent, or maybe not. But the quarter of respondents to *Emerging Trends Europe* who are still waiting for proof of it, may begin to realise that sustainability is a new rule in the post-crisis game.

As one CEO says: "The future's really green."

Figure 4 **Sector best adapting buildings to occupiers' changing requirements**



Source: *Emerging Trends Europe* survey 2014

Sponsoring organisations

PwC's real estate practice assists real estate investment advisers, real estate investment trusts, public and private real estate investors, corporations, and real estate management funds in developing real estate strategies; evaluating acquisitions and dispositions; and appraising and valuing real estate. Its global network of dedicated real estate professionals enables it to assemble for its clients the most qualified and appropriate team of specialists in the areas of capital markets, systems analysis and implementation, research, accounting, and tax.

Global Real Estate Leadership Team

Kees Hage
Global Real Estate Leader
PwC (Luxembourg)

Uwe Stoschek
Global Real Estate Tax Leader
European, Middle East & Africa Real Estate Leader
PwC (Germany)

Byron Carlock Jr
U. S. Real Estate Practice Leader
PwC (U.S.)

K.K. So
Asia Pacific Real Estate Tax Leader
PwC (China)

www.pwc.com

The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI is committed to

- Bringing together leaders from across the fields of real estate and land use policy to exchange best practices and serve community needs;
- Fostering collaboration within and beyond ULI's membership through mentoring, dialogue, and problem solving;
- 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
- Sustaining a diverse global network of local practice and advisory efforts that address current and future challenges.

Established in 1936, the Institute today has more than 30,000 members worldwide, representing the entire spectrum of the land use and development disciplines. ULI relies heavily on the experience of its members. It is through member involvement and information resources that ULI has been able to set standards of excellence in development practice. The Institute has long been recognized as one of the world's most respected and widely quoted sources of objective information on urban planning, growth, and development.

Patrick L. Phillips
Chief Executive Officer
Urban Land Institute

Joe Montgomery
Chief Executive Officer
Urban Land Institute (Europe)
www.europe.uli.org

Anita Kramer
Vice President
ULI Center for Capital Markets and Real Estate
www.uli.org/capitalmarketscenter

Urban Land Institute
1025 Thomas Jefferson Street, NW
Suite 500 West
Washington, DC 20007
202-624-7000
www.uli.org

Recommended bibliographic listing: PwC and the Urban Land Institute. *Emerging Trends in Real Estate® Europe* 2014. London: PwC and the Urban Land Institute, 2014.

ISBN: 978-0-87420-265-6

Emerging Trends in Real Estate® Europe 2014