REPORT

GRI UK & EUROPE REUNION 2024

Exclusive takeaways from annual gathering of investors, fund managers, lenders, and developers with UK and diversified Pan-European portfolios

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GRI Club

INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potentialising the real estate market.

GRI Club reports present the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report was compiled following a number of panel discussions during the **GRI UK & Europe Reunion 2024**, which gathered more than 200 leading real estate decision makers in London to exchange real insights regarding the trends, challenges, and opportunities facing market players.

Photos: GRI Club

CONTENTS

CLICKABLE TITLES

THE BIG RESET

The post-GFC real estate cycle has ended. While there has been a decline in property values similar to past cyclical adjustments, this decline is purely due to higher interest rates, not an economic recession.

The question asked during discussions was if the next cycle will resemble the previous one or the one preceding it. Although they may appear similar initially, the last two cycles differed significantly.

The new cycle begins with exceptionally robust demand and supply fundamentals, particularly in terms of the former. This can be attributed, in part, to capacity constraints within the construction sector which have hindered significant supply growth over the last 15 years. Previous resets have typically stemmed from recession and excess capacity, whereas employment today is above trend.

So, are we nearly there yet? Real estate equity prices seem to have passed the turning point, and the private market typically follows suit.

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FROM UNCERTAINTY TO OPPORTUNITY

» CURRENT SCENARIO

The real estate market as it stands is characterised by continued uncertainty in geopolitics, tight monetary policies weighing on global growth, and speculation around inflation and interest rate cuts.

Transaction volumes were dramatically lower in 2023, meaning less pricing visibility as we go into 2024. Yield decompression continues in several markets, and leverage is not accretive in most markets. Global real estate transaction volumes are significantly reduced and investment market liquidity is stabilising at low levels.

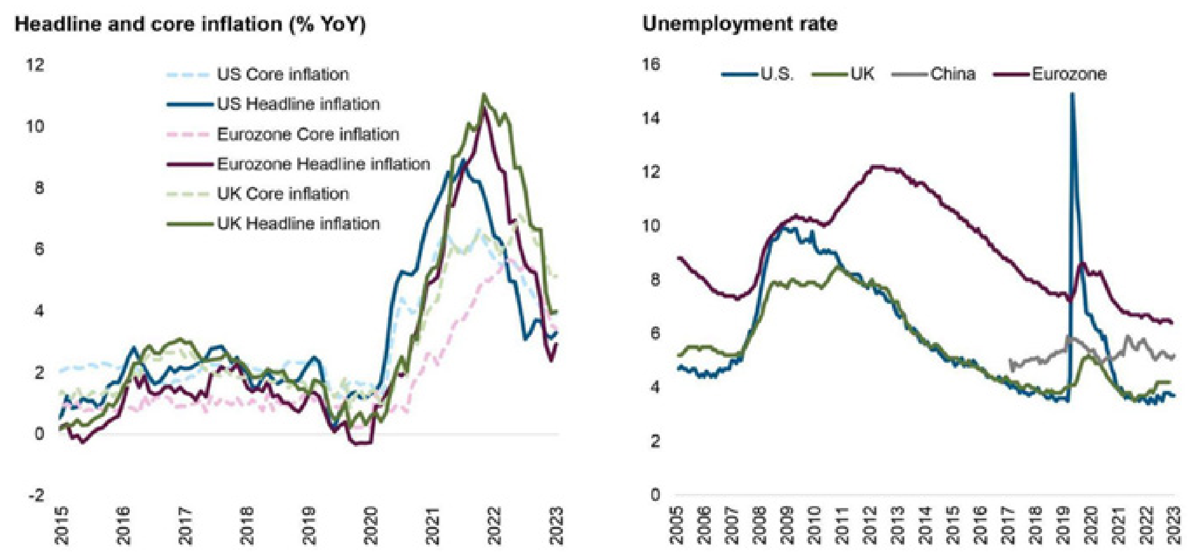
In 2024, the world is set to see elections take place across 64 countries, with more voters heading to the polls than any other year in history. The results of the US elections in particular, and the potential of a victorious Trump to exacerbate geopolitical tensions, will contribute to defining the coming years of the real estate market.

Although most participants expressed this concern, some participants cited the advantages of having a strong leader amid such geopolitical tension and threats from other world leaders, as well as the economic gains to be had under Trump's administration.

Image: rawpixel.com / Freepik

» INFLATION & INTEREST RATES

Inflation has declined from the peaks of 2022 but remains persistent due to tight labour markets.



Source: Refinitiv (January 2024)

Discussions unanimously concluded that 2024 will witness a reduction in interest rates, though uncertainty persists regarding the timing and magnitude of the cut. Nevertheless, there is a general consensus that even with the decrease already observed this year, by the end of 2024, rates are still expected to exceed the levels recorded in early 2022.

Recognition of this seems to bring a more positive and accepting understanding that rates of 0-1%, which markets became accustomed to, should not be expected to return, and in fact, rates stabilising around 2-3% would be relatively healthy.

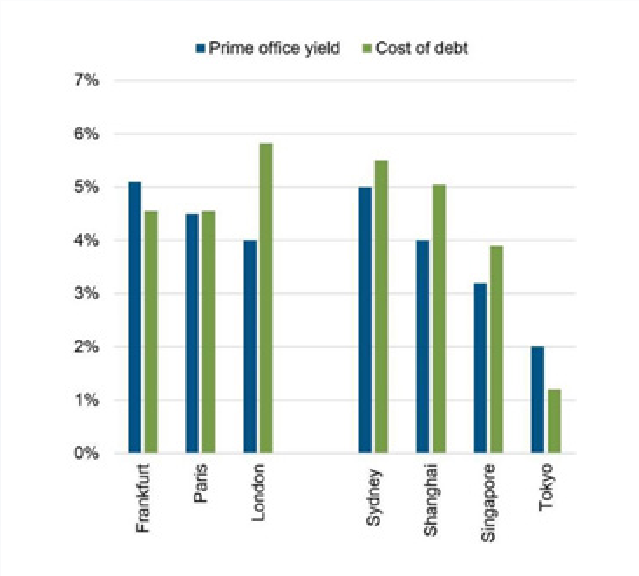
Uncertainty creates opportunity, but also frustration as investors try to call the market. As one participant noted, attempting to predict the complex intersection of inflation and rates is an inherently futile endeavour.

However, participants demonstrated rather solid agreement regarding the expectation of more pain before there is any gain, regarding the accumulated impacts of such an extended period of elevated rates, such as cash flow coverage of debt.

In due course, though, the interest rates on debt will decrease, and individuals with equity and banks with stable balance sheets will emerge to resume lending and construction.

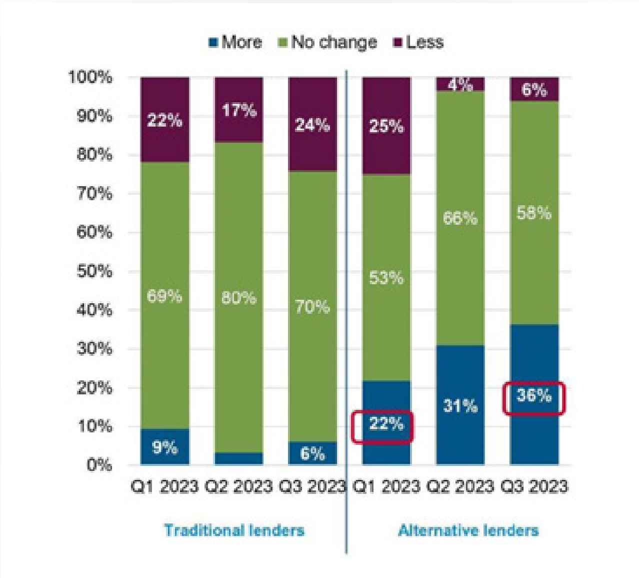
» FINANCING

Discussions raised questions about the timeframe until financing becomes accretive once more. As of Q4 2024, some European CBD office markets were either achieving or nearing positive leverage following yield expansion and decreases in swap rates.



Source: MSCI Real Capital Analytics (Jan 2024), CBRE (Dec 2024), Chatham Financial (Jan 2024), Refinitiv (Jan 2024), JLL (Jan 2024), PIMCO Prime Real Estate estimates

Alternative lenders are becoming more prominent as a financing option for commercial real estate, with conservative bank lending paving the way for European debt funds.



Source: PGIM Real Estate (March 2023), INREV (Oct 2023), PIMCO Prime Real Estate Research estimates

While banks' stringent criteria for commercial real estate lending seemed to be reaching their peak, recent revelations of CRE-related losses and risk provisions by banks in the US, Europe, and Japan suggest that any relaxation is unlikely in the near future.

DIVERGING OUTLOOK ON PROPERTY TYPES

STRESSED

Offices are experiencing extreme bifurcation by quality and location. Vacancy rates remain high despite private and government initiatives to encourage workers back into the office. A recession will lead to cuts which will not help this case. There is limited liquidity across the sector.

Retail has been experiencing a significant drop in demand in real estate due to the growth of e-commerce, pushing investors to carefully identify retail investment opportunities by assets with high traffic and/or high quality.

MODERATE

Hotels have enjoyed a tremendous comeback post pandemic, with RevPAR levels substantially higher than pre-COVID. Strong recovery has been seen especially in corporate, short-stay hospitality. Amid rising labour costs, asset owners must focus on operating margins.

Multifamily is witnessing a structural undersupply of assets. Rental growth is decelerating but fundamentals of this sector and high housing demand proves the sector more stable than most others.

HEALTHY

Logistics has been driven by the demand from e-commerce tenants to be closer to customers and population centres. The just-in-time (JIT) supply chain trend is shifting to just-in-case (JIC) to effectively manage supply chain risks which are increasingly apparent.

» 2024: A VINTAGE YEAR

Real estate investors active in 2024 are likely to be those with long term horizons. Investments are expected to centre in the liquid, transparent and high-density markets in Europe and the Asian-Pacific region, particularly in Offices and Retail, where occupiers provide a stable cash flow.

Investors are showing a clear preference for value-add and opportunistic strategies, among other higher-yield approaches, although the core market is also expected to thrive in this vintage year.

The obstacles to overcome will be clarity on geopolitical risks, inflation, and the cost of debt, as well as the need for a reassessment of the permanent loss of demand in certain sectors where physical factors have come into effect.

Image: Starline / Freepik

» REAL ESTATE DECELERATION

On an absolute investment basis, there has been a decline in allocations to real estate. This is attributed to a complex web of factors, including lower valuations and higher returns on fixed income and bonds.

For over a decade, real estate yields have remained relatively low, primarily fueled by cheap money, prevalent in Europe and other global markets. The sudden increase in cost of capital has changed the playing field and disorientated the market.

Although perceived as a short-term shock, some participants argued it could serve as a long-term boon, catalysing enhanced productivity throughout the value chain.

The industry is demanding better management of assets. Improved management can reduce operating costs, while also enhancing the service provided to tenants through means such as leveraging technology and offering a digital experience - ultimately creating real estate for which tenants are willing to pay higher rents.

This shift is poised to contribute to the overall economic productivity of society, presenting a more meaningful challenge compared to the prolonged reliance on easy access to capital and the development of real estate assets that may become untenable under normalised interest rates.

DEVELOPMENT FINANCE

The discussion began by detailing the scenario of development financing through 2023. There was a noticeable decrease in activity during the latter half of 2022 and throughout 2023, with fewer requests for acquisitions compared to refinancing.

The start of 2023 saw a brief period which suggested a return to normality, albeit amidst persistently high inflation and interest rates. However, setbacks such as bank-to-bank busts dampened optimism.

One participant reported now witnessing a resurgence in activity, particularly in acquisitions, as investors regain appetite. This uptick brings both increased competition and opportunities.

Another participant contributed UK statistics which reveal 20% of lending in 2023 was development lending - showing that development may be down, but it has most certainly not stopped.

Meanwhile, margins for development financing are currently at a 20-year peak, with an average of approximately 5.35 bps over 61% loan to cost.

Image: IR Stone / Shutterstock

» THE CAPITAL STACK

An increasing involvement of mezzanine and equity investors in the capital structure was noted during discussions.

One participant recalled their model of providing senior loans and syndicating them while holding completed projects, which has proven successful, although they revealed a willingness to fill the funding gap with entirely mezzanine lending when necessary.

There was consensus on the inefficiencies of development funding, particularly the structure involving senior and junior lending. Participants expressed frustration with the complexity and fragmentation of this approach, which involves multiple parties and reporting lines.

They advocated for greater efficiency in the market and discussed the increasing prevalence of whole loan structures which streamline processes, reduce costs, and provide greater control over financing decisions, enabling quicker decision-making in challenging situations.

» MID-MARKET DEVELOPMENTS

Mid-market schemes were suggested as having a lot to gain from tech enabled platforms which allow for the evaluation of a higher volume of schemes, with the hope that they can unlock more development, particularly in the residential market, and ultimately provide more homes.

» REFINANCING

Lenders in the room were questioned regarding their willingness to refinance in order to avoid taking over assets, to which the response was firmly in favour of flexibility. It was stressed that taking on assets is something which is avoided at all costs, highlighting their commitment to supporting sponsors to prevent such outcomes.

Image: Djspida / Freepik

BEDS

» INVESTOR SENTIMENT

Sentiment from participants regarding beds was predominantly positive. While other sectors saw significantly low transaction volumes in 2023, beds was far more active. The majority of session participants identified it as their preferred asset class for transacting in 2024.

This positivity was attributed in part to the growing number of complementary asset classes, including student living, extended stay hotels, co-living, and BTR.

This is not location dependent, and is being seen across Europe and further afield. As one participant suggested, at the end of the day, the opportunities will arise where there are strong fundamentals and a supply-demand imbalance. Beds has a firm imbalance, and this will continue in most countries for some time.

Among the concerns highlighted by participants were the high cost of finance, as well as the risk of lower quality assets. Due to production and development costs, and thus tighter margins, the quality of assets is showing a tendency of dropping.

» RENTAL CONTROLS

The question which lingers is if the rental increases will continue on their current trend. Will the government come into play and will there be rent controls? While navigating rental controls presents its own set of challenges, the prospect of the unknown represents an even greater concern due to the difficulty in underwriting for projects in locations with this uncertain backdrop.

Rental controls in Ireland, although challenging, can be underwritten, meanwhile in the UK, the possibility of controls hovers ominously.

Image: Freepik

» RETROFITTING

Discussions identified an especially attractive window of opportunity in the retrofitting or redevelopment of stranded assets or asset classes that are deemed no longer viable, particularly offices.

Considering the difficulties faced by development - brought on by high interest rates, inflation, and thus elevated construction costs - investing in existing stock is proving preferable for investors.

» BUILD-TO-RENT

The business plan of renting residential assets has been uncontested over recent years, while other sectors have struggled with inflation and the higher cost of debt.

Some sectors have endured cultural upheavals, induced by working-from-home and e-commerce trends, and, lest we forget, the global pandemic. This has forced shopping centres, offices, hotels, and other real estate asset properties to reinvent their business plans.

The housing sector continues on the traditional and robust business plan driven by tenants and rent. Coupled with the perceived undersupply of BTR assets, the sector's allure is to be expected.

The discussion revealed that on the investor side, long-term institutional capital, including pension funds and insurance companies, are showing increased desire to have more exposure to the Private Rented Sector, when compared to other sectors. This was also suggested to be the case for banks.

» LOOKING AHEAD

A potential decrease in interest rates, as indicated to be on the horizon, is poised to positively impact the BTR sector. Additionally, the aforementioned influx of capital seeking exposure to the PRS is expected to drive down the cost of capital for the sector versus others.

These reductions, together with lower OPEX, rental growth, and potential acquisition cost corrections due to changes in ownership dynamics or construction costs, could add up to make new schemes viable and get them off the ground. These factors collectively suggest promising prospects for the expansion of the build-to-rent sector in the coming year.

ESG

Conversations concentrated largely on the impact of ESG on real estate values. One participant shared data revealing that 56% of European real estate owners have witnessed a premium through ESG investment, generally accounting for an increase of 11-15% on asset value. With tenants and rental income, that increase is higher, anywhere between 11% and 25% - an encouraging result.

Further data shared by participants states the need for USD $1.7 trillion of global real estate investment per annum to reach the 2050 net zero goals. Therefore, it is crucial to question the allocation of these funds to ensure they are utilised effectively.

» DATA

Data is key to ensuring the correct allocation of ESG investments. Real estate players must face the challenge of effectively gathering relevant data at asset level, such as energy data, and model it to project where that asset will be in 2050. Decisions can then be made regarding ESG investment allocation. Asset archetypes and sectors all perform uniquely, and must be modelled specifically. With this in mind, technology and ESG are working together.

As ESG momentum grows, regulation is evolving. Banks and lenders are asking increasingly more questions, and are significantly more attentive to greenwashing than in previous years. It is now crucial to have clear evidence in the form of true accurate data proving appropriate strategies to guide an asset on the path to net zero.

» ACTION NOW

The ESG space, which previously focused on data and regulatory compliance, is progressively moving towards real action and results.

It was noted that over the past 24 months, the topic of ESG has been less present or less prioritised by investors and asset owners during discussions, including at GRI Club Meetings. When questioning this observation, it was suggested that ESG is now a part of everyone’s life. The market has therefore passed the point of discussions evaluating the necessity and viability of ESG.

It is now about action and the details of how to achieve results. One of these details is a shared reference on green value.

FUTURE OF UK

» CURRENT UK ECONOMIC SCENARIO

In the last quarter of 2023, the GDP experienced a decline of 0.3% compared to the previous quarter, signalling the UK economy's second consecutive quarter of negative growth and officially entering a technical recession.

Consequently, the overall growth of the UK economy remained stagnant throughout 2023, with a mere 0.1% year-on-year increase, marking the lowest growth rate since the financial crisis, excluding the downturn during the COVID-19 pandemic in 2020.

Nevertheless, the composite Purchasing Managers Index (PMI) rose to 52.9 in January from 52.1 in December, with the Services PMI reaching an eight-month peak of 54.3. This supports the anticipated growth of approximately 0.2% for the first quarter of 2024.

» UNEMPLOYMENT

Unemployment for the three months leading up to December 2023 was adjusted down to 3.8%, however, the ONS cautioned concerns regarding survey data accuracy. Vacancies experienced their nineteenth consecutive decrease, reaching 932,000, although the rate of decline notably decelerated.

Annual growth in regular pay, including bonuses, decelerated from a 6.7% year-on-year increase in November to 5.8% in December. Conversely, the headline measure, excluding bonuses, experienced a further decrease from 6.7% to 6.2% over the same period.

» INTEREST RATES

In the February 2024 meeting, the Monetary Policy Committee (MPC) voted 6-3 to keep the Bank Rate steady at 5.25%. However, the decision was divided, with Haskel and Mann advocating for a 25 bps increase, while Dhingra favoured a 25 bps reduction. The minutes of the meeting revealed a shift in guidance, removing mentions of further tightening and instead indicating a reassessment of how long current rates should be maintained.

Market expectations remain consistent with a projected quarter-point reduction by June, with approximately 100 bps of easing anticipated by the end of 2024. This is contested by other forecasts which suggest an initial cut to occur in May, with a total loosening of 75 bps by year-end.

» HOUSING PRICES

The most recent data on the housing market indicates that the declines in house prices may have halted or could be considerably less than initially anticipated. Cuts to the Bank Rate are also expected to provide support for house prices throughout 2024.

In January, Nationwide reported a 0.7% month-on-month increase in house prices, leading to a rise in the annual rate of house price growth from -1.8% in December to -0.2%. Similarly, the Halifax house price index saw a fourth consecutive monthly increase of 1.3% in January, pushing the annual rate up to 2.5%.

» INFLATION

In January, CPI inflation presented a slight downside surprise, standing at 4.0% year-on-year compared to the market's expectation of 4.2%. Core inflation remained steady at 5.1%, although there was a slight uptick in services CPI inflation for the second consecutive month, rising from 6.4% to 6.5%, which may raise concerns for the MPC.

Inflation is projected to decrease further, potentially dropping below 2% in the upcoming months, particularly as the OFGEM price cap is set to be further reduced in April. However, with wage growth expected to average around 5% in 2024, there are uncertainties regarding whether inflation will remain around 2%.

RISKS TO UK OUTLOOK

- **Stagnation Turns to Recession** - prolonged period of high interest rates pushes the economy into a recession.
- **Unpredictable Inflation** - elevated energy prices and an extreme winter put upward pressure on inflation.
- **Geopolitical Breakdown** - heightened conflicts and security issues including cyber threats.
- **Structural Risk** - rising government debt costs and continued low productivity growth.
- **Climate Uncertainty** - more government cuts on net zero policies resulting in a disorderly transition.

» BANK OF ENGLAND & HM TREASURY FORECASTS FOR UK ECONOMY

The UK's **GDP growth** was 0.1% in 2023. Predictions from the Bank of England (BoE) are 0.3% for 2024, and 0.8% for 2025. This is lower than the HM Treasury (HMT) forecast of 0.4% growth in 2024, and 1.2% in 2025.

Regarding **unemployment**, which currently stands at 3.8% as of December 2023, according to both the BoE and HMT, it is expected to rise to 4.5% for 2024. The BoE forecasts a continued increase to 5% in 2025, while HMT expects a slightly slower increase to just 4.6% in 2025.

The BoE measured the **Consumer Price Index** at 4.5% in Q4 2023, and predicts a drop to 2.8% by Q4 2024, and 2.5% by Q4 2025. Meanwhile HMT measured the CPI at 4.2% in Q4 2023, and expects a more substantial drop to 2.2% by Q4 2024 and 2.1% by Q4 2025.

The **Bank Rate**, which is currently at 5.25%, is predicted by HMT to decrease to 4.5% by Q4 2024 and 3.5% by Q4 2025.

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CHAIRMEN'S PREDICTIONS

The Chairmen's Predictions session, moderated by GRI Club's Chairman, Henri Alster, saw discussion regarding the outlook for the real estate market in the year ahead, and was followed by a series of voting. According to majority votes, the chairmen's predictions for 2024 are as follows:

- **Growing hostility between big nations is the biggest concern for real estate market players for 2024.**

  Being a factor that market players have very little influence or control over exacerbates this concern, as well as the acute effects on inflation and supply chains. The matter is also interconnected with the concern shown for a potential victory for Trump during the 2024 elections and resultant heightened conflict.

- **Inflation rates will stabilise between 2.5% and 4%.**

  However, it would not be surprising to see geopolitical unrest in the Middle East suddenly spurring rate increases and a surge in inflation once again.

- **Offices will be the worst performing asset class in 2024.**

  This presents an opportunity for the industry to adapt offices for the future, with environmental and occupational needs in mind. The necessity of offices remains unquestionable, but the questions are: Where will these offices be? How will they look? What will tenants need from them?

- **Residential will be the best performing asset class in 2024.**

  The supply-demand imbalance seen worldwide provides the residential sector with an uncontestable resilience.

GRI CLUB MEMBERS WILL ALSO ATTEND

GRI BEDS EUROPE 2024

Founded in 1998 in London, GRI Club currently brings together more than 15,000 senior executives spread across 100 countries, operating in both real estate and infrastructure markets.

GRI Club's innovative discussion model allows free participation of all executives, encouraging the exchange of experiences and knowledge, networking and business generation.

GRI Club Members also have access to our exclusive online platform to learn more about other members and their companies, correspond and schedule meetings, and receive unrestricted access to all GRI Club content.

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