REPORT

INVESTING IN COMMERCIAL REAL ESTATE EUROPE

An overview of GRI Club's 2023 regional events

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GRI CLUB

GRI Club is changing the game for networking and providing key market insights with its event coverage that transforms the intimate discussions of C-level executives into digestible reports.

GRI Club events are a way to pick the brains of the leading figures in real estate. This report was created after the conclusion of GRI's regional European events in the UK, Italy, Spain, France, Germany and Portugal.

Most executives at our regional events expressed hesitance in the face of deploying significant capital at this time, although there is significant dry powder available to be deployed later this year.

Germany appears to have seen more price adjustments than countries in southern Europe, but lenders across Europe are also indicating that they will be sticking to what they know, with familiar and safe asset class choices for now."

Gustavo Favaron
GRI Club CEO & Managing Partner

KEY TAKEAWAYS

Themes that echoed throughout all of the discussions were valuations, refinancing, inflation and interest rates, and prime locations being the focus of investor interests. Construction costs across Europe remain high and present difficulties for those creating new projects, and meanwhile, institutional lenders are tightening their grip on their lending choices, with alternative lenders stepping in to fill the gaps.

Alternative investment in Data Centres and Student Housing emerged as a popular choice in many countries, although this market is more developed in the UK and Germany than other areas. Many are looking to these sectors to assess strategies in order to treasure hunt for deals with higher returns compared to risk profiles.

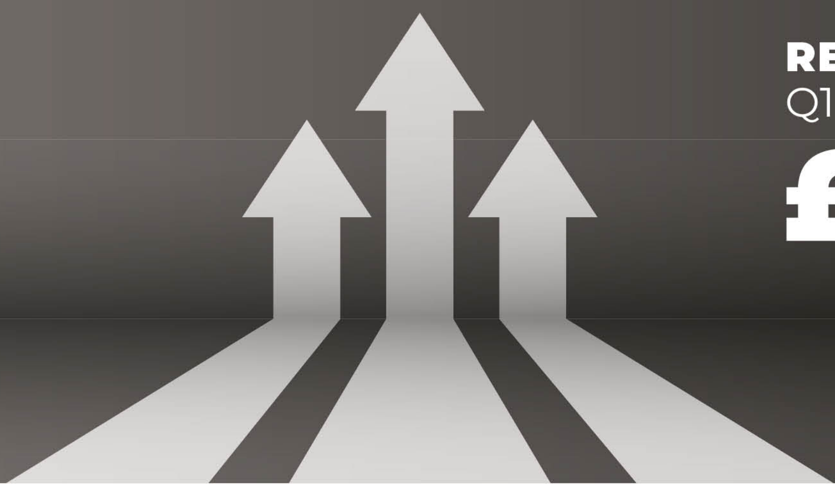
Institutional capital is trying to get into Student Housing, but in countries where the asset class is less developed there are no institutional products available and it is challenging to scale. The viability of Data Centres is concentrated around the depreciation of the value of what is within the building, as well as who is taking that capital cost, landlord or tenant. Many executives have questions about what exit strategies this asset class has.

UNITED KINGDOM

In the UK, diversification is being used as protection against inflation. Alternative Residential redevelopments from the Hospitality asset class are seen as safer income-generating assets; there is a significant amount of city centre opportunities.

Overall, Offices were a frequently discussed subject at this year's UK & Europe Club Reunion, with many feeling negative about its prospects and comparing it to Retail due to being battered by the work-from-home movement, but others seeing opportunities in its many structural headwinds.

There is a decade of transition to go through in the Office market, and many emphasise the need to use what already exists. However, refurbishment costs can be high, and may not be worth the cost in some cases. Vacancy rates are low and there is a limited development pipeline, which is in fact positive if demand returns.



RETAIL INVESTMENT
Q1 2023
£1.8BN

Meanwhile, long leases have fallen in popularity and operating businesses are going to take over. From an underwriting perspective, there is higher risk in this business model.

There are many secondary markets outside of London that have seen rapid repricing. General sentiments were that predicting occupier trends will be difficult until the end of the year, and companies will be testing the best ways and frequencies to use office spaces.

Despite a subdued investment market in Q1, Knight Frank reports that consumer markets were far more resilient than anticipated, occupier markets withstanding cost inflation pressures, a positive inflection point in retail property markets. At the Reunion, Retail was marked as a dangerous asset class, with tenant transparency highlighted as an issue.

Interest in hospitality has increased and keeps growing. COVID-19 appears to have been a game changer, accelerating the changes needed in the sector.

Much of the discussion on hospitality focused on service apartments as a growing asset class, which is true throughout the EU, although focused on main cities. An important note is that the larger the asset, the more crucial the location.

ITALY

Milan's office space market has been in a state of flux in recent years. Despite high demand for offices and office spaces, there is a shortage of options available, leading many to consider different ways of looking at the market.

An interesting aspect of the market is the shift in focus towards the city centre. In the past, developers showed little interest in developing offices in the city centre, as residential and hospitality properties dominated the area. However, this has changed in recent times, and this area is now emerging as a significant player in the Office space arena.

INVESTMENT
Q1 2023
€1BN

ALTERNATIVES SECTOR
INVESTMENTS
€222M

68%
OF **INVESTMENT VOLUME** FROM DOMESTIC SOURCES

Investing in hospitality in Italy is a great business opportunity with a significant percentage growth in tourism. Italy's hotel and leisure industry is a sector that has yet to be institutionalized, creating an opportunity for investors to add value. This is an interesting asset class because there is still room for growth. While there are issues with obtaining permits and licenses in Italy, investing in this sector can provide high returns in the long run.

The conversion of Office properties to Hotels or mixed-use projects was also one of discussion at the event. Some were unenthusiastic about the concept, as existing office buildings often do not have the space available for lobbies and amenities; for Luxury Hotels, the most trending class at this time, some are sure that these conversion projects are impossible.

The retail market has transformed into a specialist market in recent times. Newcomers are finding it difficult to enter the market due to the complexity of the retail market. Understanding the needs of retailers, physical and structural issues, and how everything comes together are the key aspects, while investors who only focus on the yields are not likely to succeed in the long term. Each property has its own unique set of challenges and opportunities, and understanding those is the key to success.

MILAN'S RETAIL MARKET, Q1 2023

	YOY CHG	12-MO FORECAST
10.8% GRADE A, B & C VACANCY RATE	▼	—
81.000 TAKE-UP SQM	▼	▼
€700 PRIME RENT €/SQM/YR	▲	▲

Source: Cushman & Wakefield

SPAIN

Spain is facing a new scenario with fewer, smaller-sized deals, and many are still waiting for price adjustments, which is something that was mentioned in GRI's first large European conference of the year in February. Overall, many believe that while yields have adjusted, asking prices for land have not.

Many investors are observing a different risk perception in the market owing to general uncertainty, and investors are more conservative in risk appetite compared to 2022. This is delaying many deals and reducing market activity. Portfolio balancing between different asset classes is now underway, especially by institutional investors and other big players.

The upcoming regulations that involve rental caps based on indexes have made investors a little more cautious; the problem is not seen to be the rental cap but instead, the indecisiveness of the government, and investors would appreciate fast, clear decision-making on these issues. Some point out that rental caps on indexation can be a positive development, particularly for institutional investors.

While in 2011-2013, activity was concentrated in Retail, in the 2020-2023 period activity has been concentrated more in Residential assets such as Co-living, Student Housing and Affordable Housing, as over the next decade the housing supply needs to increase dramatically.

SPAIN'S INVESTMENT VOLUME, 2022, AND Y-O-Y CHANGE

TOTAL VOLUME
€13.148BN

RETAIL VOLUME
€4.174BN

OFFICE VOLUME
€2.577BN

LOGISTICS VOLUME
€1.419BN

Source: Cushman & Wakefield

The executives also observe a change in occupier demand across major asset classes. Ground floor retail is dying, while there is a pickup in student housing, co-living and serviced living. Offices are moving from traditional to co-working models on the back of tenant demand and consumer use.

Overall, the Office outlook is positive. Some note that teleworking is not as popular in countries such as Spain due to cultural factors - it cannot be compared to the US market that has been affected more significantly, such as in San Francisco, which has been impacted by the majority of the tech sector not returning to offices as of yet.

FRANCE

Investors are increasingly looking for diversification and simplicity in France, while coworking spaces in mixed-use projects are growing rapidly in popularity. However, French regulations - such as those related to fire safety - can present hurdles to the successful development of such initiatives.

Demand for Offices fell by 30% in the first quarter of 2023, especially for projects with surface areas of more than 5000m². This drop was expected after the COVID-19 crisis, but it has accelerated due to the current economic crisis and compulsory teleworking.

However, Paris remains an attractive city for businesses despite this decline.The market for coworking, meanwhile, has increased by 20%. Companies are looking for more flexible and service-oriented solutions when it comes to renting workspaces that will allow them to thrive in the current scenario.

INVESTMENT

Q1 2023

€1.6BN
OFFICES

€1.3BN
RETAIL

PRIME YIELDS

3.65%
OFFICES

3.65%
RETAIL

4.40%
INDUSTRIAL
& LOGISTICS

For Logistics, In the realm of capital markets and forecasts, there is a question lingering as to whether a certain product has fallen out of favour with investors or if it simply indicates a healthy correction after a period of growth. The current situation prompts an examination of the factors influencing this outcome.

One key development in the market was the significant drop in the prime rate. This adjustment brought about an indexation of 6.5, which served to mitigate some of the challenges being faced.

With this shift, investors can anticipate a more transparent view of market prices in the coming three to six months, providing them with a clearer perspective on potential investments.

However, when considering the value-add prism, the situation becomes more complex. Developers are entering the market with parcels of land that they have acquired at high prices, surpassing €600 per square metre. This poses a challenge as the yield on cost hovers around 6%, while financing costs remain at 6%.

It was noted that the dynamics at play differ when it comes to value-add urban logistics, where the current scenario deviates from that seen in other sectors.

GERMANY

Commercial real estate is currently attractive for many investors in Germany but, despite large funds being available, money isn't entering the market because investors are waiting for prices to go down.

The investment market is somewhat blocked - banks are ready to lend, and the problem is a widespread inability to afford the loans. If the GFC is compared to now, there is currently around five times more capital on the market than at the time of the crisis, and there are positive signs according to polling of the industry.

Additional factors such as the war in Ukraine, the energy crisis, and strained relations between the US and China have only served to compound the challenges. Frozen interest rates and a significant rise in inflation have also contributed to this complex situation, leading to a collective realisation that the so-called "Golden years" of real estate were over.

These developments signify something of a regime change, with the potential to bring about a substantial and transformative shift in the industry. Down valuations are very likely and money will be lost, but the market is expected to make a full recovery - much as it did after the previous financial crisis.

Q1 2023 INVESTMENTS
€5.1BN

72% LESS
THAN EQUIVALENT
PERIOD LAST YEAR

WEAKEST FIRST QUARTER SINCE 2010

€1.6BN IN RETAIL INVESTMENTS
THE LARGEST CONTRIBUTOR

Source: Cushman & Wakefield

As a result of the interest rate turnaround in Q2 2022, yields rose strongly in Q1 2023. The yield on Logistics properties is 4.15 percent in all seven top markets, and in the first three months of 2023 prime Logistics yields rose by 15 basis points in the top 7 markets.

For Offices, Munich is the most expensive market, followed by Berlin, Frankfurt and Hamburg, and then Düsseldorf and Cologne.

Under the current scenario, it was agreed that retaining assets for the time being and waiting until conditions improve to make decisions is the best option available. The viability of this choice depends on whether tenants are able to survive and continue paying.

PORTUGAL

In Portugal, there are some uncertainties, and banks are reducing leverage or only focusing on their historical plans, and this presents opportunities for alternative lenders who provide some solutions where the banks are not there, they are sometimes complementary to banks, reaching together or sometimes on a subordinate basis, lower, and higher value.

As a result of macroeconomic concerns, investment turnover reached €239.5 million in the first quarter, a 36% decrease y-o-y. The retail sector, boosted by the completion of a large supermarket transaction, accounted for 70% of total investment volume in the first quarter, followed by the office sector with 16%. Yields remained stable even though further increases are expected in 2023.

Investing in real estate, including Offices and Retail, needs to be carefully considered, with questions about the talent pool, educational facilities, and local economy all factored into the decision. Porto was also highlighted as a primary location for commercial asset development, particularly Retail.

Portugal is facing the challenge of bringing people back to the office. Some have noticed that on most days, only 30% to 40% of workspaces are occupied. The pandemic has caused companies to rethink their approach to remote work. In order to bring people back to these spaces, Offices need to be developed with amenities that make them more attractive.

We want to ensure that the investments we make in the amenities are ones that will attract people and make sense in the long-term. Moreover, we're looking to make the whole canteen experience different and more attractive, like a global food court, a time-out market, or a shopping centre. Together with human resources, we're finding out the things that are essential and important to people, so we can prioritize what will matter.

INVESTMENT VOLUME	OFFICES CENTRAL BUSINESS DISTRICT 1	
	PRIME YIELD	PRIME YIELD CHANGE Y-O-Y
€240M	**4.5%**	**50BP**

Source: CBRE

Co-working spaces offer a flexible solution to traditional office space. Instead of being locked into a set contract, co-working operators offer the ability to expand or reduce space as needed. Whether you have a few employees or need to accommodate several more, these spaces can adapt to your needs. This approach allows companies to create a more rigorous mindset and move away from expensive offices. By utilizing co-working spaces, businesses can be assured that their needs will be met. From meeting rooms to extra beds, co-working operators are equipped to meet the demands of their tenants.

Logistic assets and Hotels are also promising avenues for financing, provided that the fund likes the asset and sponsor. Lisbon is a key location for these Hotel developments. It's essential to analyze the situation and the underwriting process to ensure it's refinanced later.

Green financing options are becoming increasingly necessary for commercial businesses to develop projects that are environmentally friendly and comply with EFG and HEE standards. Having this kind of project in place can lead to benefits such as waste treatment or energy conservation, especially for specific attempts like hotels or student housing.

GRI Club

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