For professional investors and qualified investors only

GLOBAL OUTLOOKS **2023**

Real Estate: **Preserving Value**

Joanna Tano
Head of Research,
CT Real Estate
Partners

There was a definite air of positivity in European real estate markets in January and February 2022

COVID restrictions had largely been lifted across Europe and the investment community was optimistic about the strength of the real estate market – fundamentals were solid, the occupational market was robust and there was a realistic level of achievable returns. And then late February arrived along with the invasion of Ukraine which, not in isolation, but led to the remainder of the year fraught with uncertainty.

And so, 2023 will be a year with a lingering layer of uncertainty attached to it. Investors are increasingly risk averse even though parts of the real estate market continue to support both income and growth, underpinned by robust structural drivers such as the continue march of online consumption and the lack of supply of quality housing at rent levels that are affordable. Preserving value will be at the epicentre and the forefront of investor intentions.

Issued December 2022

With energy costs having soared across Europe since March 2022 and interest rates following suit, this has refocused minds at several levels, where preserving and creating value for the future have really risen to the fore. Along with this, despite the fragility of some economies in Europe and the wait-and-see approach adopted by a number of real estate investors, there will also be opportunities. In times of more restrained capital growth, with income becoming a greater proportion of overall returns for the next few years a yield advantage strategy, combined with a top-down strategic approach, could lead to additional outperformance.

It is worth remembering for those with a vested interest in real estate that they need to try and look through the short-term haze and deploy strategies that answer to longer-term trends such as hybrid working and the continued shift of some consumption to online or the lack of the right sort of housing in the right areas. There is perhaps a misguided expectation that we are heading toward some 'fixed state'. But real estate markets are always moving, and trends will continue to evolve and impact real estate, and the solutions the sector can deliver. It is often the years after a recession or significant upheaval that the real estate sector delivers and has the potential to offer the best vintage of investments.

Performance will vary, quality is key

As the price correction, that is already underway, continues to unfold there will be varied performance across portfolios which will largely depend on the quality of assets and the breadth of sectors those

Real estate markets are always moving, and trends will continue to evolve

assets are in. As more and more occupiers look to secure space that provides them with higher levels of efficiency not solely in a bid to reduce costs, but also to attract and retain talent that are aligned to greener credentials. And this will increasingly come at the cost of brown discounts needed for older stock as green premiums for new stock is seen more and more as the norm and over time will not attract a premium but rather be expected – the balance of power continues to shift to occupiers. The resilience seen within the occupational sector over the last 12 months will lead to longer term capital preservation for landlords as they look to secure good quality space and it seems willing and able to pay for it.

Opportunities exist not only in retrofitting older stock if the balance between cost of doing so and potential income streams can be made to stack up given the inflated cost of materials and labour at the moment, but also in identifying overlooked areas with growth potential. Quality, be it immediately acquired in standing stock or realised through refurbishment and repositioning is the way forward, regenerating and/or strengthening city centres and urban areas.

Location

But location is important too, more so now than ever before. But what defines a 'good' location will vary depending on the sector. Offices for example, continue to go through the impact of the structural shift to hybrid working. Whilst the story has not yet ended and corporates continue to assess and test what strategy is best for them in a one-size-does-not-fit all world, what is increasingly obvious is that well-located offices that are accessible from a transport perspective, play a role in their communities with amenities in close proximity will be the ones that succeed and this will be at the expense of lower quality stock and lesser appealing locations.

Well-located leans to the urban centres and not just for offices. Urban centres are the hub of infrastructure such as schools and hospitals, roads and public transport networks, all of which have a role to play in a community and thus continue to be a draw for people, all of whom need somewhere to live. And this plays into the hands of the transition of the living sector from an alternative real estate class to a mainstream one. The sector has proven to be more resilient over the last 12 to 24 months. Housing is in high demand countered by low levels of supply and even lower levels of quality supply. Investors are prime placed to help bridge the supply gap while creating a positive social impact at the same time and capture both income and growth.

As the E in Environmental, Social, and Governance (ESG) becomes more a given than a nice-to-have, and is regularly embedded into the capex programme, attention is, and will, continue to be given to the social component of the equation, a large impact of which can be achieved through placemaking and delivering well thought-out mixed-use developments. For example, if proposed regulation in terms of Energy Performance Certificate (EPC) ratings comes to fruition, there will be large swathes of residential stock that does not qualify to be let and is often in the hands of private landlords. This leaves opportunity in the market for investors to step in and not only upgrade parts of this stock though decarbonisation and digitisation but use the opportunity to create and influence the development of communities by not replacing a like for like, but instead perhaps replacing with a mixed-use development helping to create healthy, sustainable communities with a breadth of employment and growth potential.

So, in 2023 whilst we don't have all the answers, the direction of travel is clearer.

What defines a 'good' location will vary depending on the sector

To find out more visit **columbiathreadneedle.com**

Important Information