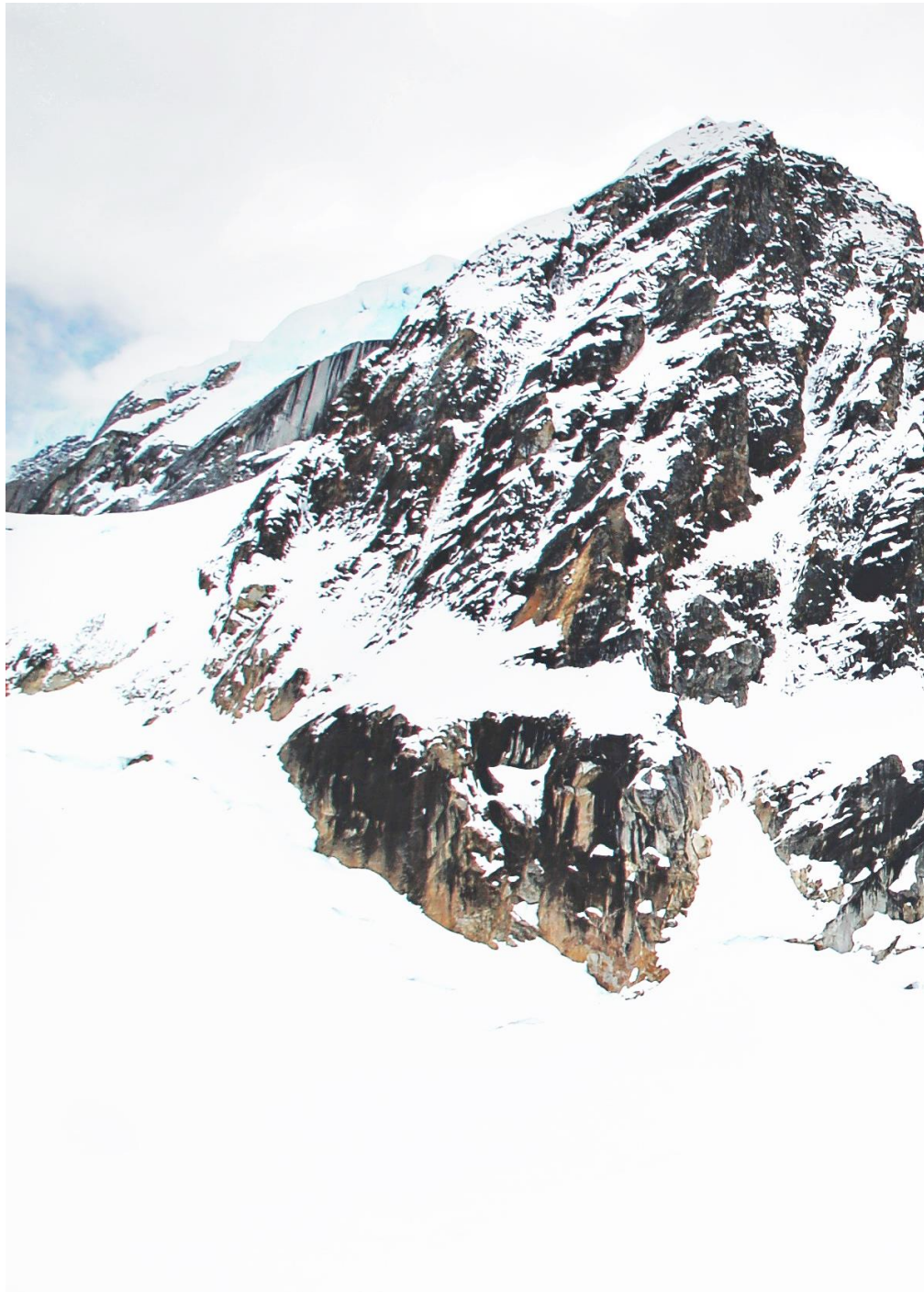


Real Estate Outlook

Europe – Edition 1, 2022



Inflation yet to peak.



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European outlook

Uncertain months ahead.



Just as the COVID-19 pandemic appeared to be behind us, a war has started as Ukraine was invaded by Russia. We are not anticipating significant direct impacts on the European property market outside of CEE. However, the indirect impacts of higher energy costs and weakened business confidence may slow the economic recovery. Historic evidence suggests property pricing usually remains stable during crisis events unless accompanied by a major economic downturn.

Market overview and outlook

Moving from one crisis to another.

Economy

Europe was already grappling with inflation at the highest level in decades before Ukraine was invaded by Russia, and with energy prices set to continue to rise during the course of 2022 this will place further pressure on consumer confidence and spending power. Business investment may also be eased back in-light of the heightened uncertainty and geopolitical risks, and energy intensive industries will suffer disproportionately. New conflict zones will disrupt supply chains further and the cost of shipping will rise in-line with higher oil costs.

European growth was forecast to be significantly above trend in 2022 as markets are still catching-up the lost ground from the COVID-19 pandemic, and whilst we don't anticipate growth reversing as a result of the war the pace of growth is likely to fall back, particularly if the war is protracted over the course of the year. Central banks may look past the higher inflation and reduce expectations for future rate rises to avoid placing further pressure the cost of living, which would provide some support for both private and public asset pricing.

Despite the escalation, we expect the direct impacts of the war in Ukraine on commercial real estate to be limited. Investors may show increased hesitancy on Baltic markets and Central and Eastern European markets closer to the Russian sphere as higher risk is priced into valuations. More broadly, there may be some impact at the super-prime end of the residential market in key cities where wealthy Russian individuals have acquired assets which could be frozen, but this is not going to impact the wider residential market.

Occupier markets

The fourth quarter of 2021 showed some further positive signs of recovery in European office markets, with take-up recording its strongest quarter since the pandemic and the pace of increase in vacancy rates continuing to slow (see Figure 1). We still expect occupiers to take a more active approach to future space requirements in 2022, as new working patterns become more consistent.

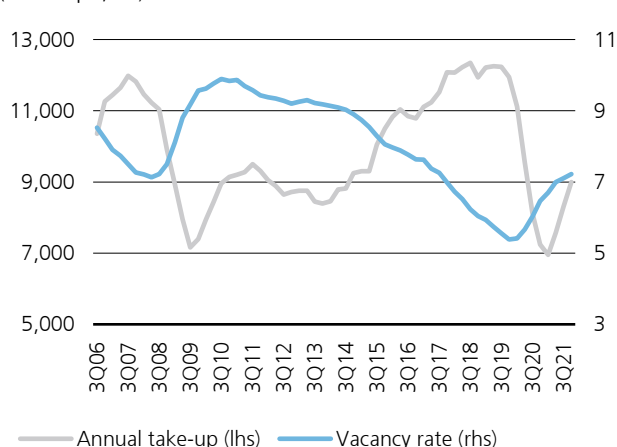
This will only benefit the buildings in the market which are compatible for post-COVID-19 occupation. For example, in Central London 90% of take-up in 2021 was for Grade A space. The remaining part of the market will need to see significant capex, and for assets in weak locations obsolescence rates are set to accelerate.

The prime retail occupier markets continued to show signs of stabilization, with just the UK seeing rental declines in 4Q21. Amsterdam even recorded a marginal (2% QoQ) recovery according to JLL data. However, weakness persists in secondary pitches and shopping centers remain challenged across the continent. Logistics markets are more buoyant with a handful of markets recording prime rental growth in 4Q21. Though, it is questionable whether the rental growth levels will justify the ultra-low entry yields. With inflationary cost pressures coming from all angles, the willingness or ability of logistics operators to pay ever high rents will be tested in the coming quarters.

Capital markets

A significant amount of capital has already been earmarked for deployment into European real estate this year and we think the majority of that capital will still be deployed, although there may be some more caution in the coming months and deals could take longer to complete. At this stage, we would not anticipate significant movements on the pricing side. Looking at historic crisis events, there is very little evidence to suggest there is a direct impact on property yields where the event has not been accompanied by major economic challenges. There is, in fact, some evidence that core property is seen as a safe haven asset during times of crisis and yields have moved in. Whilst pricing may prove to be resilient, lenders are likely to require higher spreads to reflect the heightened risk premia and general negative sentiment in financial markets.

Figure 1: European office take-up and vacancy rate
(‘000 sqm, %)



Source: JLL, 4Q21

Strategy viewpoint

European life sciences poised for growth.

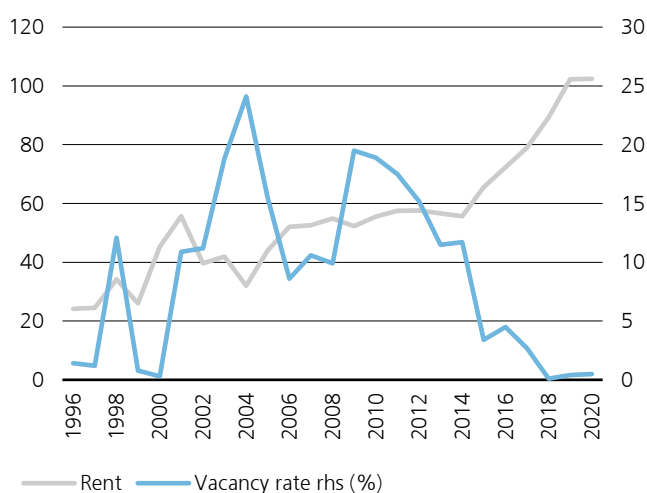
Fad or long-term growth opportunity?

It is no coincidence that the surge in interest in life sciences real estate in Europe emerged during the first major global pandemic in over a century. But as the pandemic (hopefully) fades away, will this emerging sector also run out of steam?

To enter into a relatively niche and extremely competitive real estate market, it is essential that the underlying occupier fundamentals will repay the risk with consistently high-income growth during the holding period. Essentially, the supply and demand balance need to be completely optimal to either justify development risk, or ultra-low yields for existing assets. Life sciences real estate demand is relatively unique as it has a clear correlation with VC funding coming into the sector.

After companies receive the funding, they have a relatively short window (on average less than a year) to take on new space to facilitate additional R&D or manufacturing of treatments. This is net demand for new space, rather than churn which predominantly drives the traditional office market.

Figure 2: Lab space rent and vacancy rate in East Cambridge, US (USD/sqft, %)

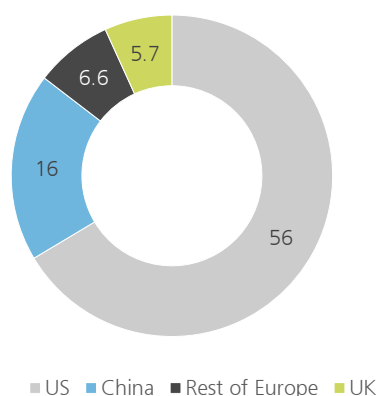


Source: JLL Lab Market Overview, August 2020

The consequence of the weight of funding going into the sector is that companies generally do not release space back onto the market. They grow rather than relocate. And as life sciences companies' real estate requirements are very specific in terms of location and design, the supply of space in any life

sciences cluster can run down very quickly. Even in mature markets such as Boston where there are specialist developers, they cannot keep pace with demand, keeping availability near 0%. (see Figure 2). With so few options for expanding companies, double digit rental growth (% y/y) has been achieved.

Figure 3: 1Q-3Q21 VC life sciences investment (%)



Source: JLL, September 2021

Europe is still a very different market to the US. Even with an increase in interest, the VC capital going into European companies in 1Q-3Q21 was just 22% of the US total (see Figure 3). But there is a clear trajectory of more funding targeting companies based around the top R&D universities in Europe. Whilst the sector is high on everyone's agenda, there are few specialist players with the track-record to deliver the right space for occupiers under a strict timeline.

This creates a window of opportunity to pre-emptively follow the funding capital, and target markets in Europe where there is a particular hub of excellence in one area of bioscience research. These are not necessarily in the largest traditional office markets, and we foresee better opportunities emerging outside of the crowded core markets where even traditional office yields are at record low levels.

Better long-term returns can be achieved by focusing on the growth trajectory of the underlying companies which, for bioscience research, are often outside of the core cities. In these locations, there is a more attractive entry yield and long-term prospects to work with key occupiers in the market to deliver the much-needed real estate to support their innovative health research.

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