Real Estate 2017

A look inside the European real estate market
The 2017 European real estate market’s positive outlook on disruption and interest rate risk

The 2017 European real estate market is grappling with the various disruptive forces of urbanization, technology and demographics. Despite these challenges, the real estate industry is expected by many to be busier and more profitable in 2017. Optimism is clear among real estate professionals despite uncertain economic conditions and the threat of interest rate tightening.

Capital values have significantly outgrown occupier rents in most European markets. “Property prices are defined by the amount of capital that one can find—not value,” commented a real estate investment manager in a recent PwC survey. Increased allocations to real estate by investors in both opportunistic and core funds have created a large wall of capital that must be deployed. This availability of capital is driving activity more so than the fundamentals.

Discussions with investors at the MIPIM conference in March 2017 indicated that some are worried that the real estate cycle has peaked. Many made comparisons with the 2007 peak, where the market was awash with liquidity but relatively low profitability. This is further impacted by expectations of higher interest rates in the coming years.

To address these concerns, many investors are looking towards the residential sector to find yield as retail and office sectors have seen their returns compress. Investors are now also focusing on assets outside prime locations or in areas affected by significant infrastructure investment.

In order to capitalize on these opportunities, real estate investors will need to ensure that their talent is up to the task. Digital expertise, creativity and an eye for value will enable the best real estate firms to outperform their peers.
Investing in a megacity hypertrend

**Beyond the capitals**
- While traditional hubs such as Paris, London, Frankfurt and Milan remain attractive to real estate investors, there is a move to investing beyond the major hubs into cities such as Manchester and Düsseldorf, where both the risks and the yields are higher.
- With cities turning into megacities, developments are being made where the transportation infrastructure allows easy access, expanding the boundaries of cities such as London as far out as Reading and bringing high levels of investment outside the city center.
- **This will require firms to attract and retain talent with expertise outside the main business hubs of Europe.**

**Transportation**
- Investment in cities’ transportation systems has a significant impact on the real estate of those cities. Looking at the volume of activity and construction around transportation points to new areas of urbanization and improvement.
- Cities across Europe such as Paris and London are facing mounting pressure to cut pollution and the number of cars. Such cities are investing heavily in better transport into the city center, leading redevelopment around these transport hubs. For example:
  - London’s successful redevelopment in King’s Cross and the investment in the Crossrail suburban rail has substantially changed these areas.
  - Milan’s plans for the Lambrate area reinforce this trend.
  - Newer financial hubs such as Canary Wharf and La Défense are continuing to expand via both residential and commercial development.
- **These new areas provide great opportunities for large-scale developers to generate new capabilities and projects in residential, as well as commercial, development.**

**Lifestyle schemes**
- With the combination of having better access to transport and new, high-density residential areas being developed, we are seeing an increase in the development of large lifestyle schemes.
- This trend builds on what we have seen on the west coast of the United States, with large outdoor schemes combining commercial, retail and entertainment all within one complex.
- Some cities have started to develop such schemes (Bicester Village, Westfield, both near London), but this is a big opportunity for developers, particularly in growing satellite cities beyond the capitals.
- **In order to succeed in lifestyle developments, investors must go beyond bricks and mortar and think about developing user experience and placemaking expertise.**

**Affordable housing**
- Expanding city populations is a key trend due to extended life expectancies and smaller family size, as well as immigration not only from within the country but also from around the world. These pressures are causing an affordability crisis in a number of cities, and many developers and investors are looking toward various forms of affordable housing.
- **Developers will need to invest in talent that can develop assets with cost-efficiency in mind.**
## A changing market

**Co-living spaces**
- Partially due to cost pressure, millennials—young adults between the ages of 21 and 33—are expanding their residential preferences to include co-living schemes.
- These tend to be large, luxurious university-style halls of residence that have shared kitchens, libraries, rooftops, cinemas and other amenities targeting millennials.
- **There is a scarcity of talent with a proven “creative” track record in real estate, including attracting younger demographics.**

**Student housing**
- Students studying abroad or away from home is common, and investing in apartment blocks dedicated to students is increasingly attractive.
- With a lower investment compared with offices and a higher turnover of tenants, investors also have guaranteed security via parents signing off on the lease.
- **Investors have targeted these student accommodations around university campuses as a prime development and investment opportunity.**

**Pure-play to bricks and mortar and vice versa**
- Many e-commerce platforms are now making a move into traditional brick-and-mortar retail, as well as brick-and-mortar retailers moving toward online fulfillment:
  - In the United States, Warby Parker, an online optician, is aggressively expanding its physical presence. Similarly, Amazon is currently beta testing its new store in Seattle.
  - In Europe, retailer Carrefour has recently acquired Altarea Cogedim’s Rue du Commerce, providing Carrefour with a foothold in e-commerce and new logistical and location challenges for its distribution centers.
- **Firms must have agility in repurposing space as the needs of their key clients change.**

**Shorter term and more flexible commercial leases**
- Companies have been increasing their staffing density due to confluence of technological advances such as video conferencing, cloud-based document sharing and internal instant chat systems. These innovations have improved the efficiency in working away from the office, therefore decreasing the need for corporate square footage.
- These trends also give companies the freedom to hire part-time/freelance employees on a project basis, which heightens the need for flexible and alternative working spaces.
- Currently, companies such as WeWork are subleasing flexible space and are generating significant value for themselves.
- Similarly, retail space in Europe is moving toward greater flexibility with the advent of pop-up stores and shorter leases. While this provides less long-term security for investors, it allows for greater dynamism in the industry, with those investors in a position to take advantage of this shift able to profit.
- **Developers and investors should be aware of the opportunities, as well as the potential operational changes, that would be required to exploit these opportunities.**
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AUTHORS
European Real Estate team: Paul Jaeger (Paris), Lamees Al-Ashtal (London), Lionel Boisse (Paris), Maria Buttiglieri (Milan), David Detrilles (Brussels), Burak Gorbon (Dubai), Pedro Lerma (Barcelona), Patricio Malone (Paris), Ron Weihe (Frankfurt) and in conjunction with Eric Girma and Constance Courtenay

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