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Europe Real Estate sector report

FALL 2022

Sector conditions and outlook[1]

Sector		Current conditions	Outlook
OFFICE	The prospects for long-term office demand remain unclear and strongly debated amongst investors. Despite record low unemployment levels across Europe, daily office occupancy is still well below pre-pandemic levels in most markets. Therefore, the office sector remains bifurcated with demand most focused on high-quality assets in core submarkets. Although investment volume has slowed significantly, competition for high-quality and sustainable office spaces has intensified. Flight-to-quality and efforts by investors and occupiers to cut carbon footprint will continue to propel the demand for prime space and widen the polarisation between best-in-class versus older, inefficient office buildings.		
INDUSTRIAL	Elevated inflation and shrinking disposable income for European households is likely to affect retail sales, including e-commerce. Additionally, rising base rates and borrowing costs could ultimately cause yields to soften from the actual record low levels. However, occupier demand remains strong, with vacancy rates reaching new lows in several markets. Some companies are reconsidering their manufacturing footprint and reducing their dependence on components produced in Asia. This re-shoring trend is likely to herald a new cycle of capital expenditure for manufacturing and warehousing space in core markets over the medium term.		
RESIDENTIAL	Given the structural deficit and the defensive nature of housing, we expect the sector to perform well on a relative basis even in the face of a European recession over the next 12 months. However, the pace of housing price growth will moderate to a low single-digit as rising mortgage rates, and pressure on debt affordability will curb demand. With fewer households being able to purchase a property, rental solutions may become a more popular choice, although the squeeze in disposable income will limit the ability of landlords to pass on higher rents.		
HOTEL	The gradual return to normal life and pent-up leisure demand drove a sharp recovery in the sector in the summer of 2022. By mid-year many markets had fully recovered to 2019 RevPAR levels driven by an increase in room rates with occupancy levels still lagging 10% – 20% below peak. The luxury segment performed particularly well across the major tourist destinations, while business travels remain below pre-pandemic levels due to work-from-home policies, teleconferencing technology, and an uncertain economic outlook. Despite this strong recovery, we are cautious about the remainder of 2022 and early 2023 as inflation levels continue to be high and the cost of living drag on disposable income increases risks of demand reduction.		

KEY:

● Improving ● Neutral ● Deteriorating

↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

Sector conditions and outlook continued

Sector		Current conditions	Outlook
RETAIL	The cloudy economic outlook has weakened the prospects of the retail sector, which may now be facing another difficult year. Consumer spending has held reasonably well so far, supported by a strong labour market and sizeable savings accumulated during the months of lockdown. However, persistently elevated inflation and rising utility bills will likely squeeze real income, weigh on purchasing power and eventually alter discretionary spending over the second half of 2022. Necessity-based retailers, food stores, DIY, and retail warehouses are likely to perform relatively better in the remainder of 2022 compared to shopping centres and high street retailers.		
DATA CENTRES	Contrary to other asset classes whose demand has weakened in 2022 amid a bleak global economic outlook, activity in the data centre market remained buoyant. Take-up in Europe's five largest markets, soared in Q2 2022, driven by near-record demand from hyperscalers, which continue to expand their operations. Supply remains constrained and not sufficient to cater for the growing operators' appetite as both enterprise and consumer-oriented cloud markets keep on growing rapidly. Tenant stability, low churn levels, and the ability to pass on costs to customers are some of the factors contributing to a large influx of capital into the sector, especially from private equity companies.		
HEALTHCARE	Healthcare is capturing growing interest, especially among long-term investors, attracted by demographic trends and increasing demand for high-quality care provisions. Since the highs of the pandemic, patients' well-being and occupation levels returned to normal levels. However, the current economic environment is posing new challenges for some operators whose solvency may be threatened by the rapid rise of input costs and borrowing rates. Large companies may consolidate their position by acquiring more fragile operators, while investors may secure real estate assets in exchange of fresh capital, also through alternative finance solutions.		
STUDENT HOUSING	The student housing sector has been one of the most resilient during the pandemic in terms of investment volume, and year-to-date figures show it is on track to reach a new record this year amid a countercyclical nature and strong underlying fundamentals. Occupational levels of purpose-built student housing accommodation are at record highs in several European university hubs and demand is expected to increase in the medium term. Even assuming a recession in 2023, the prospect of the sector remains positive as typically, during economic downturns, the number of higher education students doesn't decline due to lower opportunity costs and fewer job opportunities.		

KEY:

● Improving ● Neutral ● Deteriorating

↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

[1] Outlook refers to the next 12 months

Source: Principal Real Estate, September 2022

OFFICE

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↘	→	↘	↗	↓	↓

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Private equity

Over the past two years, the traditional use of offices has been tested by the COVID-19 pandemic and hybrid working. To reduce the spread of coronavirus, all non-essential workers were forced to perform their duties from home, pushing European offices occupancy rates down to single digits during the highs of the pandemic. Meanwhile, the share price of remote working enabling technology companies increased by several times in less than a few months. Several coronavirus waves hit Europe before clouds finally dissipated at the back end of 2021 when high vaccination rates allowed governments to reopen their economies, and people to gradually return to normal life.

By then, the office sector seemed to be poised for a rebound. Pent-up demand and a resurgence in cross-border transactions lifted investment volumes in Q1 2022 above pre-pandemic levels in many European core markets. However, the rebound has been short-lived as stickier hybrid working practices have collided with growing recessionary fears and tightening monetary policy.

As a result, we expect the office market to remain bifurcated with demand most focused on high-quality assets in core submarkets. Although the overall investment volume slowed down significantly, in Q2, competition for high-quality and sustainable office spaces has intensified. For example, in Germany, prime rents in Berlin, Düsseldorf, Frankfurt, Hamburg, and Cologne have all continued to rise over the second quarter of 2022, in some cases significantly, and despite a mounting risk of energy rationing in the coming winter, due to heightened geopolitical tensions with Russia. In France, in the Greater Paris region, substantial contrasts were also evident, with availability falling in the most sought-after markets of Inner Paris, La Defense, and Western Crescent in Q2 2022, while significant volumes of supply remain in most suburban markets. With strong demand and limited supply, upward pressure on prime rental values of new or refurbished buildings was maintained, and in some cases reached new records. Flight-to-quality and efforts by governments, investors, and occupiers to cut carbon footprint of the built environment will continue to propel the demand for prime space and widen the polarisation between best-in-class versus older, inefficient office buildings. This latter property type, which constitutes most of the sector, remains the most exposed to capital value decline and yield adjustment in the medium term.

Public equity

The office sector has on average performed in-line with the broader property sector this year, but there are wide disparities around this mean, with Switzerland and the Benelux most resilient while the Nordics and Germany the weakest (companies listed there are amongst the most leveraged in the sector).

The prospects for long-term office demand remain unclear and strongly debated amongst listed real estate investors. While there has been a strong rebound in employment and hiring as the economy rebounded from the COVID shutdowns, working from home remains surprisingly widespread and daily office occupancy is still well below pre-pandemic levels in most markets, particularly in London.

The strength of office demand varies by market, with only tech and life sciences tenants growing on a net basis overall. Leasing has picked up and vacancies are shrinking, but there is substantial bifurcation within office markets. ESG is increasingly important for both tenants and landlords, with an increased focus on energy efficiency, flexibility, staff retention and employee welfare favouring newer high-quality assets. As a result, prime buildings in the best locations have been stronger than secondary assets and locations in almost all markets, and secondary vacancy rates are typically 5-10% higher than prime. Office landlords need to increase capex to counter the risk of obsolescence and stranded assets, and while headline rents have not moved much, incentives have increased.

The listed sector is typically trading at a discount to last reported NAV of approximately 30%. With prospects for the sector very cloudy, more M&A activity could emerge to exploit the valuation gap between public and private markets. The listed sector typically owns assets at the better end of the quality spectrum.

INDUSTRIAL

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↗	↘	↑	↗	↘	→

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Private equity

The industrial and logistics sector has consistently outperformed the wider property market over the past two years, propelled by the rise of e-commerce and a boom in online shopping caused by the social restrictions imposed to contain the COVID-19 pandemic. The sector delivered attractive performance in 2021 and Q1 2022, with total return index reaching 26.8% and 6.2% respectively. Meanwhile, transaction volumes doubled pre-COVID average in 2021 and marked the second-best quarter on record in Q1 2022. Hence during that period, prime yields compressed significantly, down to around 3.5% in core markets, with some assets attracting below 3% levels. Income returns are now below 5% in most European cities except for secondary locations in some western and southern countries.

The question is now whether the sector will continue to outperform or instead will lose momentum amid tightening monetary policy and declining consumer sentiment. So far, the sector has proved to be resilient, but a few signs that macroeconomic headwinds may impact industrial properties have started to emerge. According to INREV, overall net sentiment towards the industrial sector turned negative, with 20% of the respondents intending to decrease allocations and for the first time since the start of the survey none intending to increase it. Elevated inflation and shrinking disposable income for European households is likely to affect retail sales, including e-commerce. Additionally, rising base rates and borrowing costs could ultimately cause yields to soften from the actual record low levels, as it started to happen in the UK and Germany, the two largest European industrial markets, over Q2 2022.

Meanwhile, occupier demand remains strong, with the vacancy rate reaching new lows in several markets. Manufacturing is expected to increase its share of take-up over the coming quarters as logistic bottlenecks caused by the COVID-19 pandemic and heightened geopolitical tension have exposed the fragility of global supply chains. Some companies are reconsidering their manufacturing footprint and reducing dependence on components produced in Asia. This re-shoring trend is likely to herald a new cycle of capital expenditure for manufacturing and warehousing space in core markets over the medium-term.

Public equity

Industrial has performed broadly in-line with the property index in Q2 and YTD. It held up well early in the year despite the Ukraine war before selling down heavily in Q2 after comments by Amazon about over expansion during COVID and concerns about a significant pull back in demand going forward from

the e-commerce giant (and potentially other 3PL firms). Demand side data has held up well through H1, despite Amazon pulling back significantly on their take-up, assuaging some concerns over low cap rates in a rising interest rate environment remain. Structural tailwinds should continue to support decent rental growth in industrial going forward, albeit perhaps lower than before.

Industrial REITs now trade at a small discount to NAV on average, having come down from the large premiums they traded at before the Amazon concerns surfaced. The more development exposed stocks suffered most in the sell down, as they previously traded at the largest premiums and now there is the most uncertainty about medium term development prospects.

RESIDENTIAL

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↗	↗	↑	↗	→	↓

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Private equity

The European residential sector was one of the most dynamic over the last two years, together with industrial. Lack of supply, low-interest rates, and growing institutional appetite drove prices upward even during the highs of the pandemic. According to the European Commission, house prices in the EU have risen by 45% since 2016, with nearly half of that growth occurring in the past two years. Given the structural deficit and the defensive nature of housing, we expect the sector to perform well on a relative basis even in the face of a likely European recession over the next 12 months. However, the pace of housing price growth will moderate to a low single-digit as rising mortgage rates, and pressure on debt affordability will curb demand. Exceptions to this trend may occur in countries with a high number of mortgage holders and a large share of borrowers on variable rates. In these countries, including Sweden and Norway, the housing market is more exposed to changes in interest rate policies and may witness some price softening should inflation remain elevated, and the ECB decides to hike rates aggressively.

With fewer households being able to purchase a property, rental solutions may become a more popular choice. However, rental growth is likely to be milder than in the past two years. The squeeze in disposable income and the fall in real wages in many instances will limit the ability of landlords to pass on higher rents to those households already struggling to cope with the current energy crisis and cost of living crisis. Additionally, in some European countries such as Denmark and Ireland, national governments have set a ceiling on housing rent increases to 4% a year for the next two years to relieve the burden on tenants. Other governments, including the UK, are considering implementing similar measures for social housing occupiers at least.

The current climate of economic uncertainty prevailing not just in Europe but across all major world economies is likely to peak in the winter when inflation and energy demand are expected to touch the highest point. This period may offer interesting investment opportunities as the European residential sector remains underpinned by positive structural drivers and supply-demand unbalance. The bleak economic outlook and high construction costs could further limit new development projects, enhancing the attractiveness of the sector over the medium-term.

Public equity

The European housing sector has underperformed again in 2022, hurt by rapidly rising bond yields with rental growth lagging badly behind. While over the longer-term residential rents have historically been a good inflation hedge, the backward-looking multi-year periods used to calculate the rent indices for regulated housing in markets such as Germany, mean that it will be some time before in-place rental growth catches up with or overtakes inflation again.

In addition, higher real yields and credit spreads in the corporate bond market have pushed up the cost of refinancing maturing bonds, squeezing the margin between property yields and finance costs. However, mortgage finance from banks remains readily available at tighter spreads. The sector has also been hurt by a perceived overhang as new equity was needed to finance proposed acquisitions announced

near the end of 2021 (but some options will no longer be exercised as equity market conditions have deteriorated).

Higher energy and construction costs have also hurt the housing sector beyond just driving up inflation, as in those markets (like the Nordics) where heating costs are included in the rent, margins will be hurt by higher energy costs. In markets where energy costs are paid by tenants, their resulting reduced disposable incomes raise doubts about the level of rent increases possible.

Given the strong demand and limited supply of affordable housing in most markets, rents should continue growing, but the outlook for values is more uncertain. Higher base rates and credit spreads, combined with some large companies looking to deliver through sales, raise concerns that current low cap rates may be unsustainable, and thinning transaction volumes this year back this up. The deteriorating outlook for growth as the sector has moved from acquisitive growth to deleveraging has resulted in a sharp derating, with the sector now trading at an average discount of approximately 55% to last published NAV.

HOTEL

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
→	→	→	↗	↘	↓

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Private equity

The hotel sector has been one of the most exposed to the COVID-19 pandemic. Governments imposed travel restrictions and containment measures in Europe and beyond have caused an unprecedented challenge for operators. Around 76% of all hotels in Europe were closed at some point during lockdowns. The gradual return to normal life and pent-up leisure demand drove a sharp recovery in the sector in the summer of 2022. By mid-year many markets had fully recovered to 2019 RevPAR levels driven by an increase in room rates with occupancy levels still lagging 10% – 20% below peak. The luxury segment performed particularly well across major tourist destinations, such as Barcelona, London, Paris, and Rome. Meanwhile, revenues from business travels remain below pre-pandemic levels as work-from-home policies, teleconferencing technology, and an uncertain economic outlook have weighed on demand.

Despite this strong recovery, we are cautious about the remainder of 2022 and early 2023 as inflation levels continue to be high and the cost of living drag on disposable income increases risks of demand reduction. The midscale hotel segment may carry the highest downside risks as budgets are squeezed due to the current rise in living costs and to a slowdown in the economy. The median low-cost airline ticket for example has already increased by 120% compared to one year ago, reaching a price that may deter some leisure travellers with lower income.

Under the current economic environment, the luxury segment may be more resilient and has traditionally been a better hedge of inflation, but careful market selection remains crucial. Value add opportunities in highly sought-after sub-markets with strong leisure demand are our recommended strategy.

Public equity

Hotels are very small in the in European listed index with only one index play available (a Swedish listed pan-European player, an asset-heavy non-REIT) while other non-index plays are mostly through asset light operators. The sector has outperformed the broader property index in Q2 and YTD as the last remaining restrictions on hotels re-opening post-COVID rolled off (Germany) and demand for European travel surged following two years of tight COVID restrictions. Leisure demand has remained very strong, while business and group travel has also begun to recover. Airport travel chaos and cost of living concerns (high inflation and limited wage growth) are having little impact so far on the pent-up demand following the last two years of restrictions. With inflation surging across Europe, hotels have been seen as a good inflation hedge because they can reprice their rooms daily. Rates have recovered strongly (approximately 10% ahead of pre-COVID levels in Q2), with occupancy still lagging (circa 10% below pre-COVID levels).

Hotel NAV estimates are now back to pre-COVID levels, having declined approximately 10% during COVID, although concerns remain about cap rate expansion with interest rates generally rising across Europe. At the end of H1, asset heavy hotel stocks traded at circa 10% discounts to consensus NAV reflecting a strong recovery YTD but also come caution heading into a likely recession towards year end. Asset light players have generally performed in-line with asset heavy peers in Q2 and YTD.

RETAIL

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↘	↑	↘	→	→	↓

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Private equity

Retail assets' performance diverged significantly during the COVID-19 pandemic. Necessity-based retailers came through in a much better shape compared to discretionary shops, or those easily replaceable by e-commerce. While food stores, DIY, and retail warehouses investors' demand was buoyant throughout the pandemic, shopping centres and high street retailers started to recover only towards the end of 2021 when the lift of social restrictions and the return to normal life reinvigorated services output and retail sales.

The outbreak of the conflict between Ukraine and Russia in February 2022, and the economic sanctions that followed, changed the macroeconomic outlook significantly, weakening the prospects of the retail sector, which may now be facing another difficult year ahead. So far, consumer spending has held reasonably well, supported by a strong labour market and sizeable savings accumulated during the months of lockdown. However, persistently elevated inflation and rising utility bills will likely squeeze real income, weigh on purchasing power and eventually alter discretionary spending over the second half of 2022. This applies to most European countries, but particularly to the UK, where real disposable income had fallen for four quarters in a row for the first time since records began, and to Germany, which relies more than other countries on supplies of energy from Russia.

According to the latest monthly figures, retail trade volume weakened across most Eurozone economies in June 2022 compared to the same month last year, with the largest drop seen in Denmark (-9.5%), Germany and Ireland (-8.8% each), while the UK saw a minor decline (-3.4%) in July. Meanwhile, many retail companies are preparing for tougher times in the months ahead by strengthening their balance sheets and implementing measures to limit the erosion of profit margin.

Public equity

Retail has outperformed this year due to a strong post-lockdown re-opening rally in the first half of the year and low starting investor expectations being met or surpassed. This rally has petered out more recently as multi-decade high inflation, fuelled by spiking energy costs, has raised concerns about retail property's continued relative resilience in the face of falling real disposable incomes, deteriorating consumer confidence and central banks' determination to squash inflation by tightening monetary policy even in a weakening economy. As a result, larger regional malls, and city-centre shops more reliant on discretionary and tourism-driven spending have been weaker, while convenience and supermarket-anchored retail have been more resilient.

By the end of the first quarter, almost all remaining pandemic-related restrictions had been removed across Europe and tenant sales and footfall rebounded strongly. While typical footfall is still around 20% below pre-COVID levels, tenant sales have now recovered to pre-COVID levels as basket sizes have expanded to compensate. After the extreme stress of COVID-related closures and rent

holidays, rent collections and vacancies have now normalised for the listed sector, while rent levels and values are now stabilising after steep falls over the last few years.

Retail REITs still trade at large discounts to NAV, at an average of approximately 35% below last published NAVs. While there is less immediate concern about REIT balance sheets now, most retail REITs are still trying to deleverage by shrinking their asset base.

The slow return of liquidity in pockets of the market has allowed limited progress in this endeavour, with uncertainty highest regarding the size and price level for the largest regional malls where only the biggest investors compete and there are some over-leveraged sellers. Retail property owners continue repurposing excess space for alternative uses where this makes economic sense.

DATA CENTRES

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↑	↘	↑	↗	→	N/A

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Digital technologies have transformed several aspects of society and the economy. Working, learning, healthcare, or shopping are a few examples of activities that people, and businesses can perform online. The current digital transition is so significant that the European Commission refers to the years leading to 2030 as the "Digital Decade". During this time, Europe plans to reach ambitious digital targets, which include tripling the proportion of businesses using advanced cloud services, digitalising 100% of public services, and extending 5G and VHCN (very high-capacity networks broadband) coverage to all households across the EU27 region.

The additional capacity and infrastructure required to accommodate this growing demand make the data centre sector an attractive investment opportunity. Contrary to other asset classes whose demand has weakened in 2022 amid a bleak global economic outlook, activity in the data centre market remained buoyant. Take-up in Europe's five largest markets, namely Frankfort, London, Amsterdam, Paris, and Dublin (commonly known as "FLAPD"), soared in Q2 2022, driven by near-record demand from hyperscalers, the largest cloud computing providers, which continue to aggressively expand their operations. Demand was particularly high in Frankfurt and London, which accounted for the vast majority of take-up. Meanwhile, the average vacancy rate across FLAPD declined to a new low of 15%. Supply remains constrained and not sufficient to cater for the growing operators' appetite as both enterprise and consumer-oriented cloud markets keep on growing rapidly.

Going forward, tier two markets are set to reach the highest capacity expansion, from the current low initial starting point. Barcelona, Milan, and Rome are forecast to triple the amount of data centre power over the next four years, with a further 11 markets set to double their power capacity over the same period. The attractiveness of the sector can also be seen by the growing number of assets and data centre providers being acquired or backed by private equity investors, which also account for a large share of new developments in less mature markets. Tenant stability, low churn levels, and the ability to pass on costs to customers are some of the factors contributing to the large influx of capital into the sector.

HEALTHCARE

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↗	→	↗	→	→	↗

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Healthcare is still a nascent real estate sector due to its size and fragmentation, both in terms of segments and provision systems across European countries. However, it is an asset class that is luring growing interest, especially among long-term investors, attracted by demographic trends and increasing demand for high-quality care provisions. Transaction volumes for Senior Leaving and Care Homes, the two largest investment healthcare segments declined marginally during the first year of the pandemic, but recovered since, reaching an all-time high in 2021, equal to €9.1bn. Germany, UK, and France accounted for 72% of total European volume and most of the absolute growth over the year prior. Preliminary figures for the first half of 2022 point to a marginal slowdown, which however remains in line with the last five-year average. Since the highs of the pandemic, patients' wellbeing, and occupation levels returned to normal levels.

However, the current economic environment is posing new challenges for some operators whose solvency may be threatened by the rapid rise of input costs, including food, utility bills, and borrowing rates. Large operators may seize the opportunity to acquiring more fragile companies and consolidate their position in mature markets, such as Germany and the UK.

Opportunities over the coming 12 months may also arise for those institutional investors pursuing long income strategies with social benefits. By offering alternative finance solutions such as sell and leaseback to operators in search of fresh capital, these investors may secure real estate assets with strong tenancy, long lease, and solid prospective. After all, the need for beds is only expected to rise in the coming decades. According to the latest European Commission's Ageing Report, the share of people aged 65 years, or more is set to increase from 20% to 30% of the total population over the next 50 years.

STUDENT HOUSING

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*
↑	↗	↑	↗	→	→

KEY: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

The student housing sector has been one of the most resilient during the pandemic. Investment volume in Western Europe (incl. UK) more than doubled in 2019 to about €10bn and remained close to that level since. Year-to-date figures as of August 2022 show the sector is on track to reach a new record level driven by the countercyclical nature of the asset class and strong underlying fundamentals. Student accommodation has a track record of being relatively recession-proof when compared with office or retail asset classes. During most recessions since the 1960s, the number of higher education students has increased rather than fallen, as the opportunity cost to join a college or university drop significantly when job opportunities become harder to find. Even in the current macroeconomic environment characterised by elevated inflation, the sector can benefit from its short-term price dynamics which are tied to the academic periods, rather than a lengthy contract. Occupational levels of purpose-built student housing accommodation are already at record highs in several European university hubs and demand is expected to increase in the medium-term. Rising participation rates in higher education, growth in international student flow and supportive government policies are the major contributors to the positive outlook of the sector.

The UK is the world's second-largest student housing market behind the U.S., and remains the largest by far in Europe, accounting for circa 50% of total annual transaction volume. Other university hubs in France, Spain, and Germany are seeing a pick-up in investment activity too and we believe these markets are set to offer significant investment opportunities over the next five years as the student population increases and the provision of purpose-built accommodations raises from the current low base, which at present ranges from 5% of total students in Italy to 20% in Denmark. The growing number of universities offering courses in English, and the exclusion of British universities from the EU student exchange programme because of Brexit are likely to provide a positive tailwind to the development of university hubs in mainland Europe. Therefore, we expect student housing stock to rise and the yield gap with other residential asset types to narrow in these markets.

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