



Disruption and conviction

Insights into value investing in Europe

Q1 2023

Investing today. For tomorrow.

Executive summary: The value opportunity in Europe is born of disruption, but built on conviction

Disruption

- Markets move from the domain of risk to the domain of uncertainty
- Situational, discerning investment style preferred to sector stratification

Uncertainty



Opportunity



Conviction

We believe that the future of Europe is:



Smarter



Greener



Older



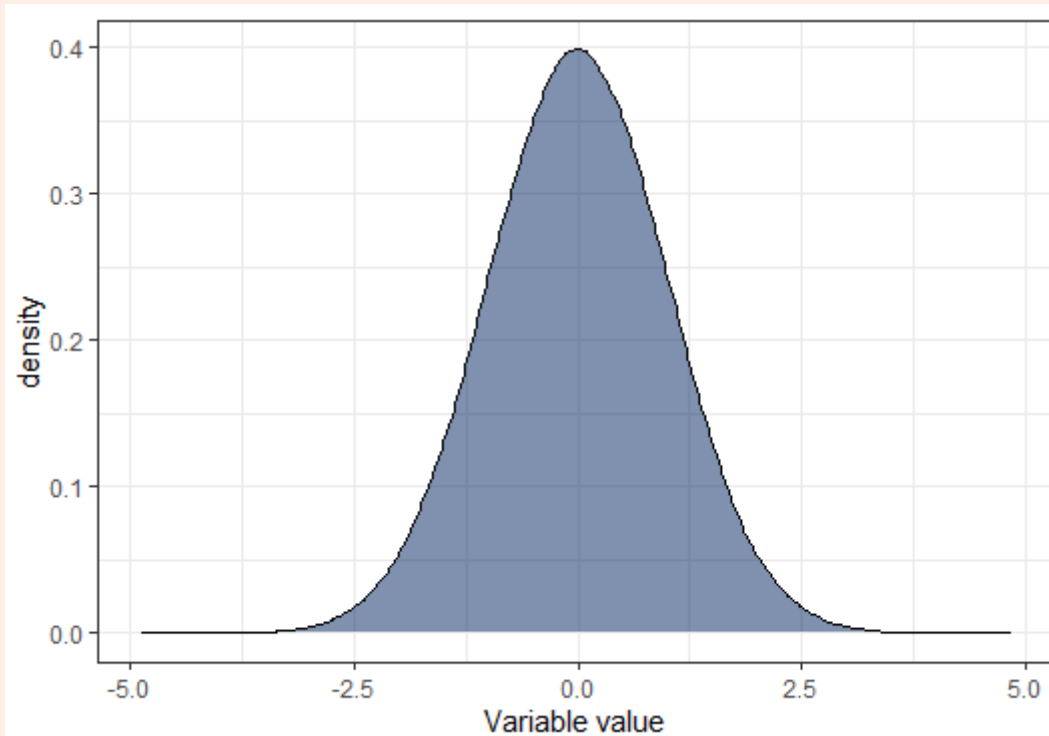
More mobile

And value investors will be critical to providing the real estate this Europe needs.

Distinguishing between risk and uncertainty

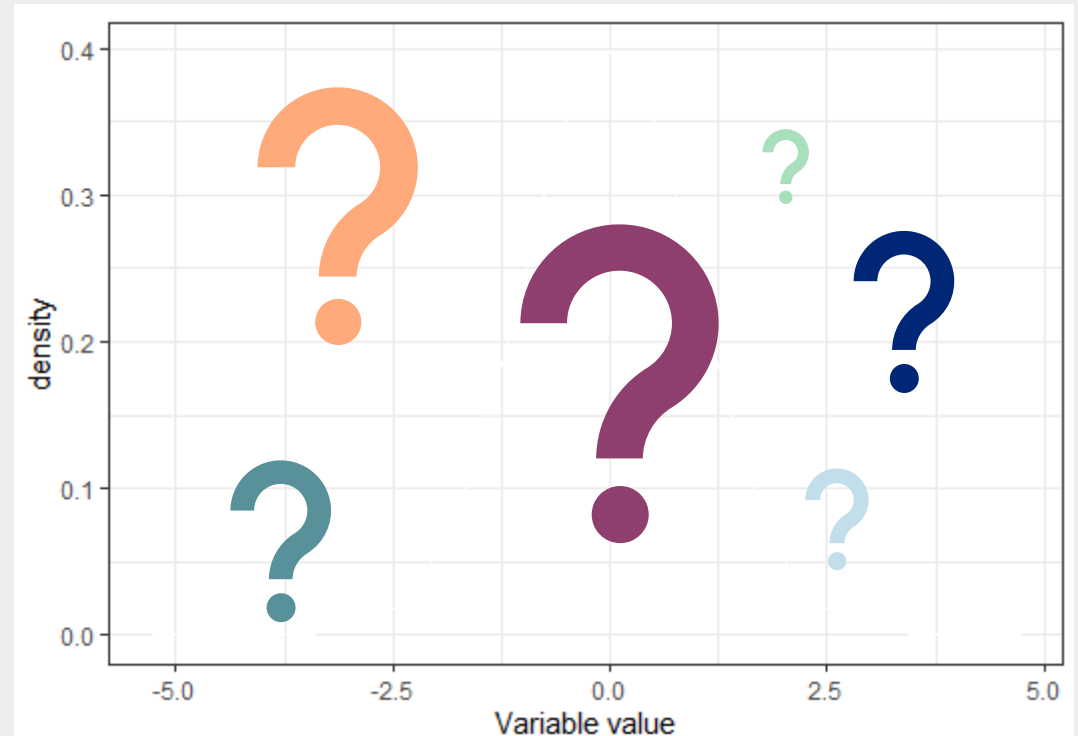
Risk

- Quantifiable, with knowable probability distributions
- Portfolios can be modelled with high accuracy
- Returns likely to fall within an estimable range



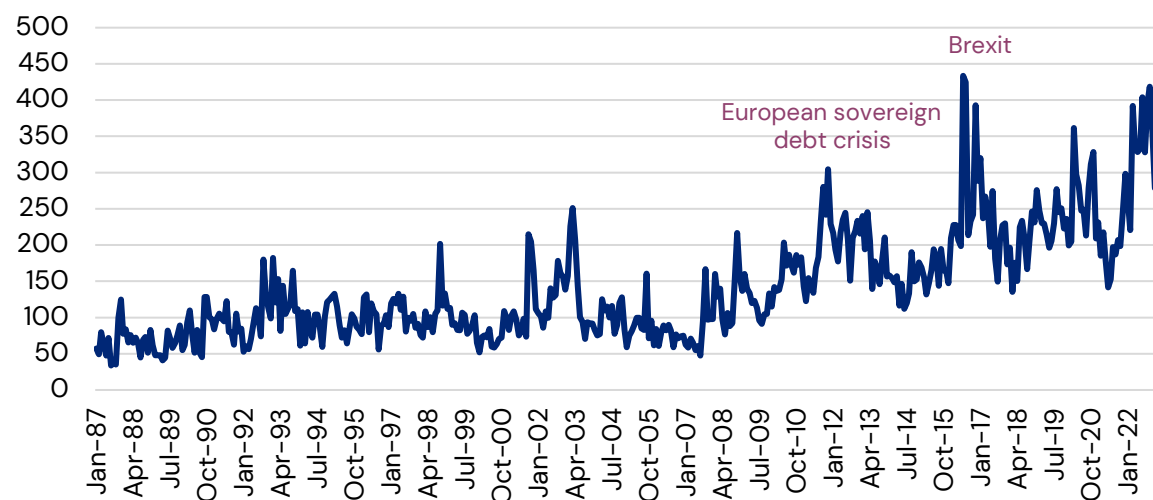
Uncertainty

- Probability parameters unknowable, many structural breaks
- Portfolio modelling likely to be unreliable
- Range of returns harder to estimate but likely to be much wider, with opportunity for significant outperformance

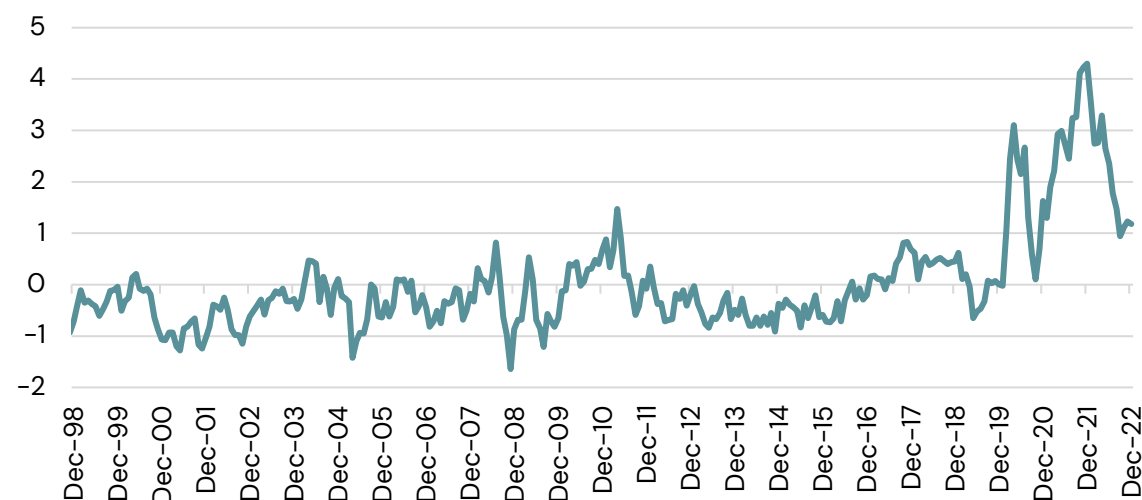


Current macroeconomic environment is characterised by uncertainty, not by risk

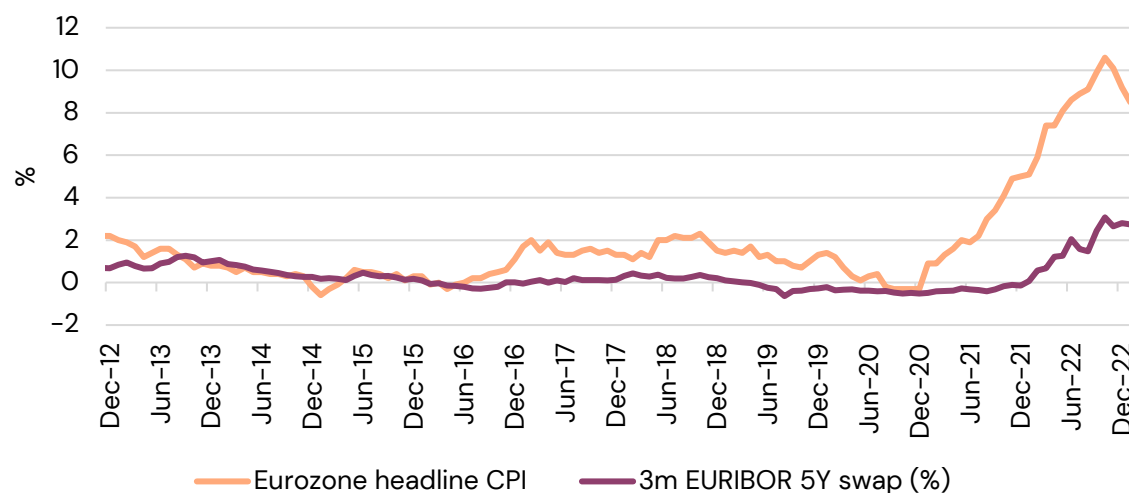
European Economic Policy Uncertainty Index



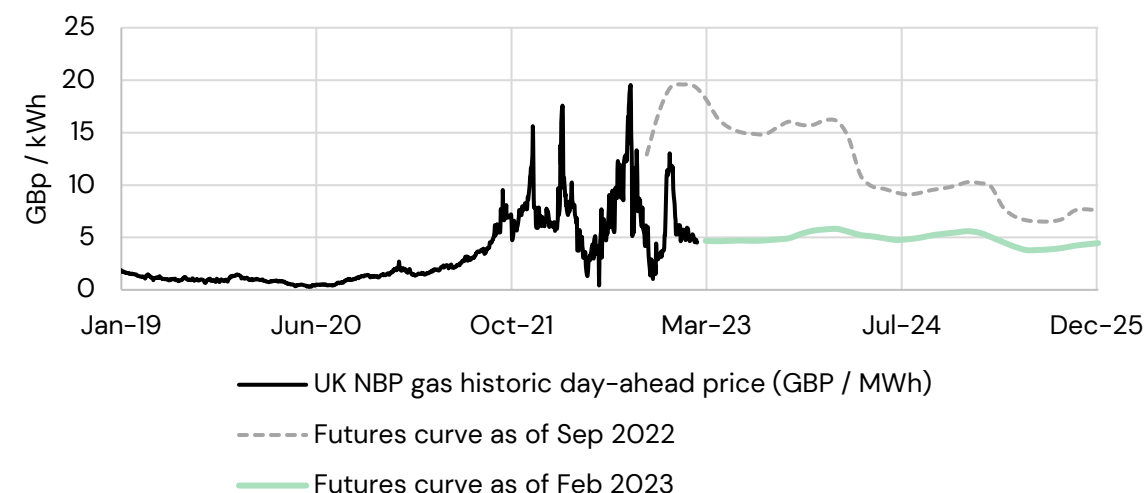
Global Supply Chain Pressure Index



Eurozone inflation and EURIBOR swap rates



UK natural gas pricing



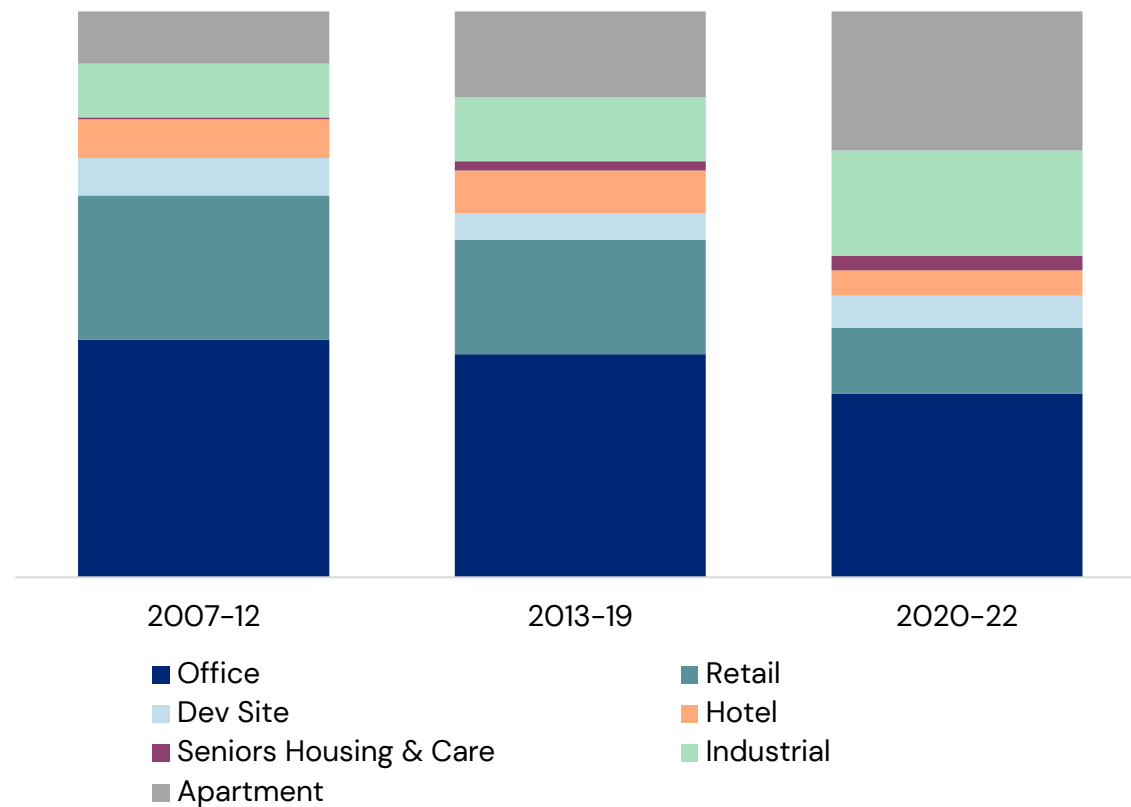
- Quantifiable investment risk and unquantifiable economic uncertainty can predominate at different times. The recent shocks to the global economy – including Brexit, the Covid-19 pandemic and its aftermath, and the Russian invasion of Ukraine – have moved the focus of many investors from measurable market risk into the domain of uncertainty. Immediately-consequential prices such as energy, food and policy interest rates have moved sharply higher and become more volatile, as have broader sentiment barometers such as the NY Fed’s Global Supply Chain Pressure index, and the Economic Policy Uncertainty Index.

Source: NY Fed, Economic Policy Uncertainty, Refinitiv, LaSalle (02/23)

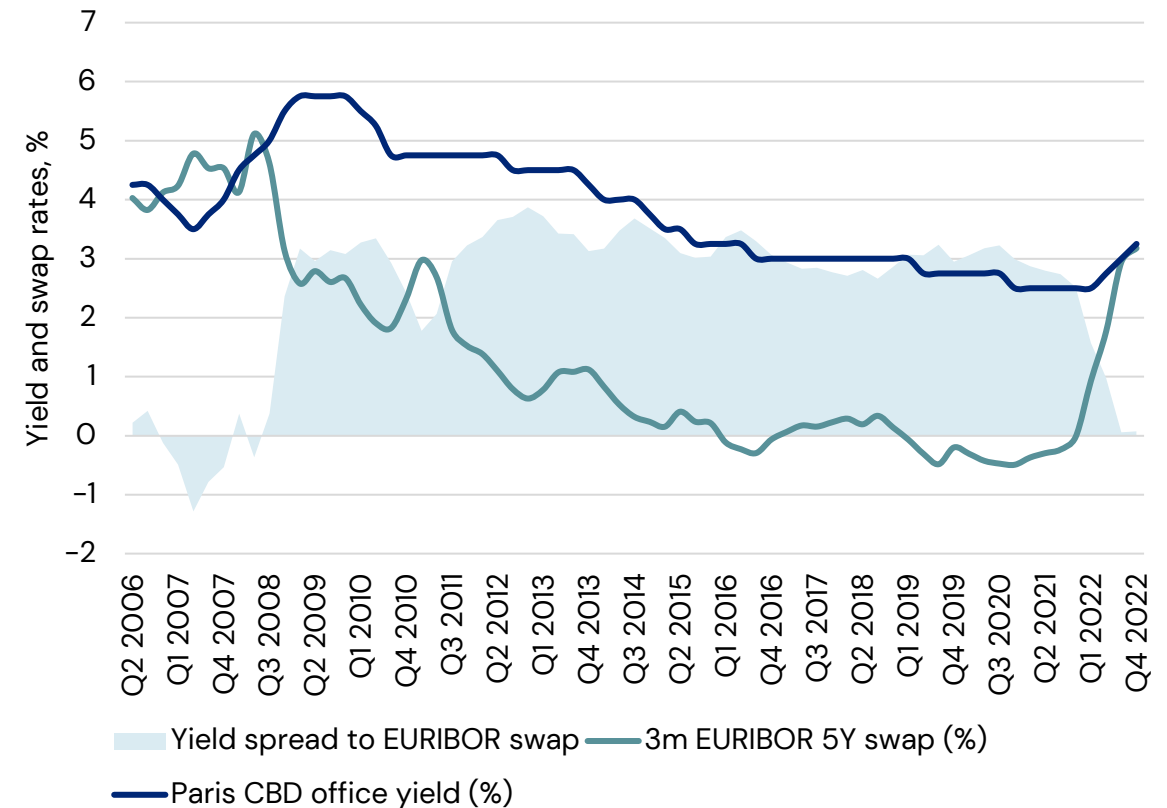
No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

Situational investment style likely to outperform broad sector plays

Sectoral share of RCA transactions



Prime yield spread to 3m EURIBOR 5y swap



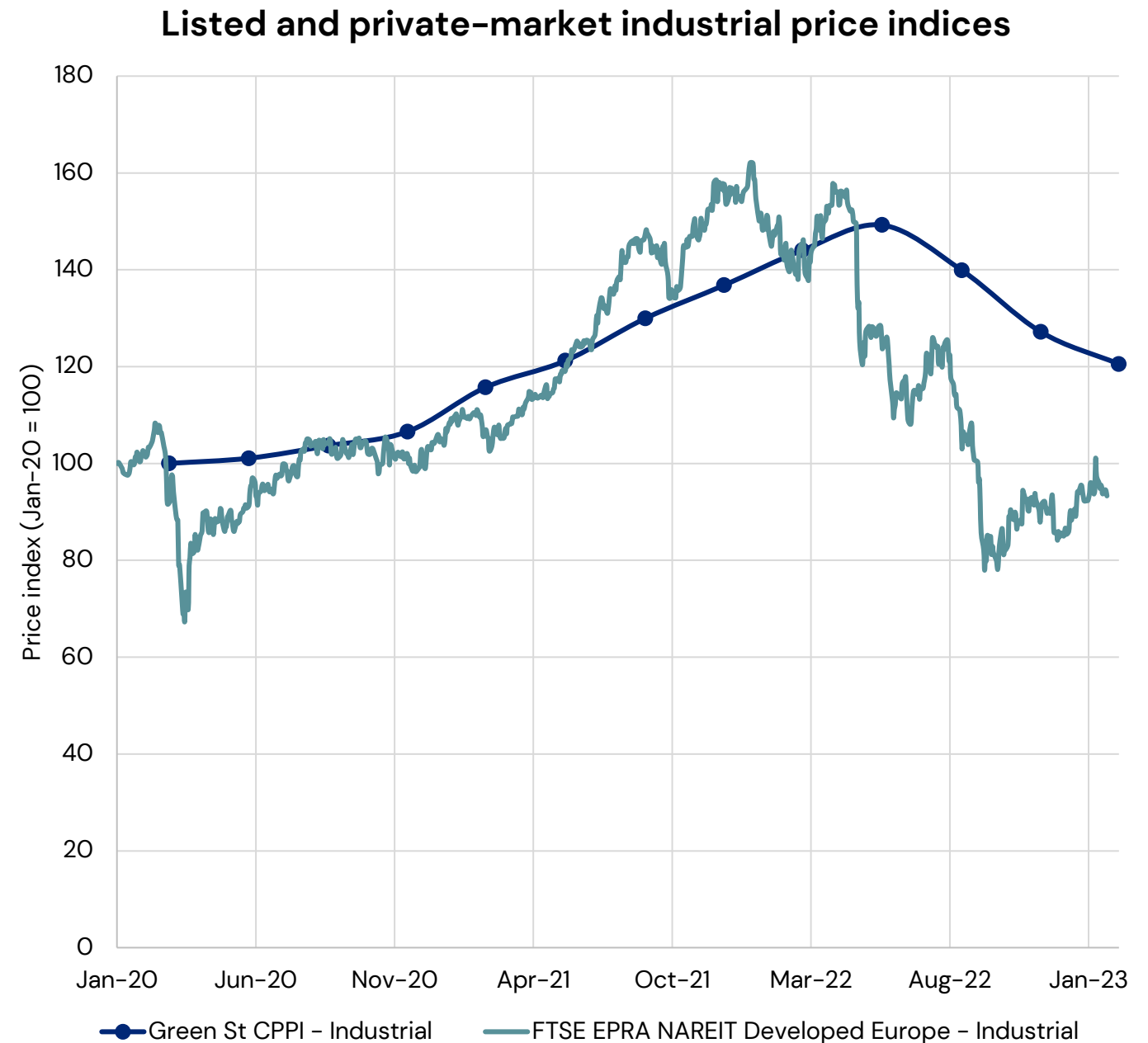
- Against this backdrop of uncertainty, real estate investors will have to be more discerning in evaluating investment opportunities. The sector stratification that has been the predominant driver of returns in recent years saw the ‘in-favour’ sectors, residential and logistics, more than double their share of RCA transactions – from 18% of transacted value in 2007-12, to 43% in the years 2020-22.
- The sharp increase in swap rates as monetary policymakers attempt to contain inflation, has however had a particularly profound impact on the sharpest-yielding sectors. Though prime-quality assets and particular sectors including urban logistics retain among the best income growth prospects, the widespread re-rating of risk assets has seen revaluations overcome the lower income yields from the most tightly-priced real estate, leading to negative total returns.
- This significant reversal in the terms of debt – often leading to leverage becoming unaccretive for core investors – saw transactions slow meaningfully during the second half of 2022.

Source: RCA, JLL, Refinitiv, LaSalle (02/23)

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Uncertainty can result in attractive entry pricing

- Broad hesitancy in real estate capital markets can create attractive entry pricing opportunities for investors with strong convictions. The existing lag between transacted asset prices and valuation-based indices is exacerbated as uncertainty causes transaction volumes to fall, in a feedback loop.
- Public markets provide higher liquidity and microsecond-frequency pricing, but may also overreact. Nevertheless, the FTSE EPRA NAREIT Industrial price index for developed European economies fell over 40% in 2022, while Green Street's Commercial Property Price Index, reflecting private assets, peaked in Q2 2022 and has since fallen by less than 20%.
- Against this backdrop of pricing uncertainty, investors willing to underwrite strong convictions may be able to turn wide bid-ask spreads for private assets to their advantage.

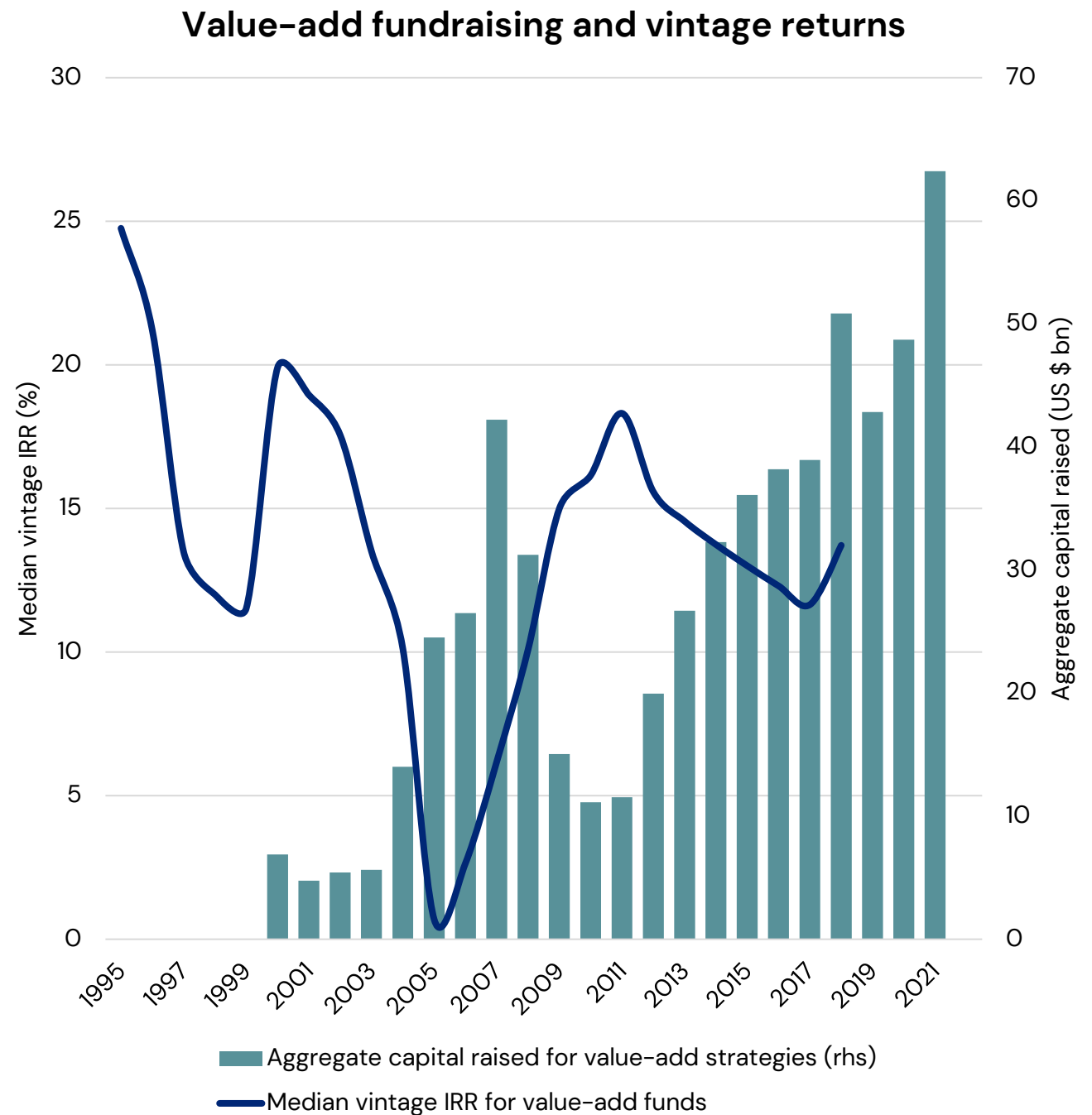


Source: Green Street, FTSE EPRA, Refinitiv, LaSalle (02/23)

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Fund vintages raised in uncertain times can outperform

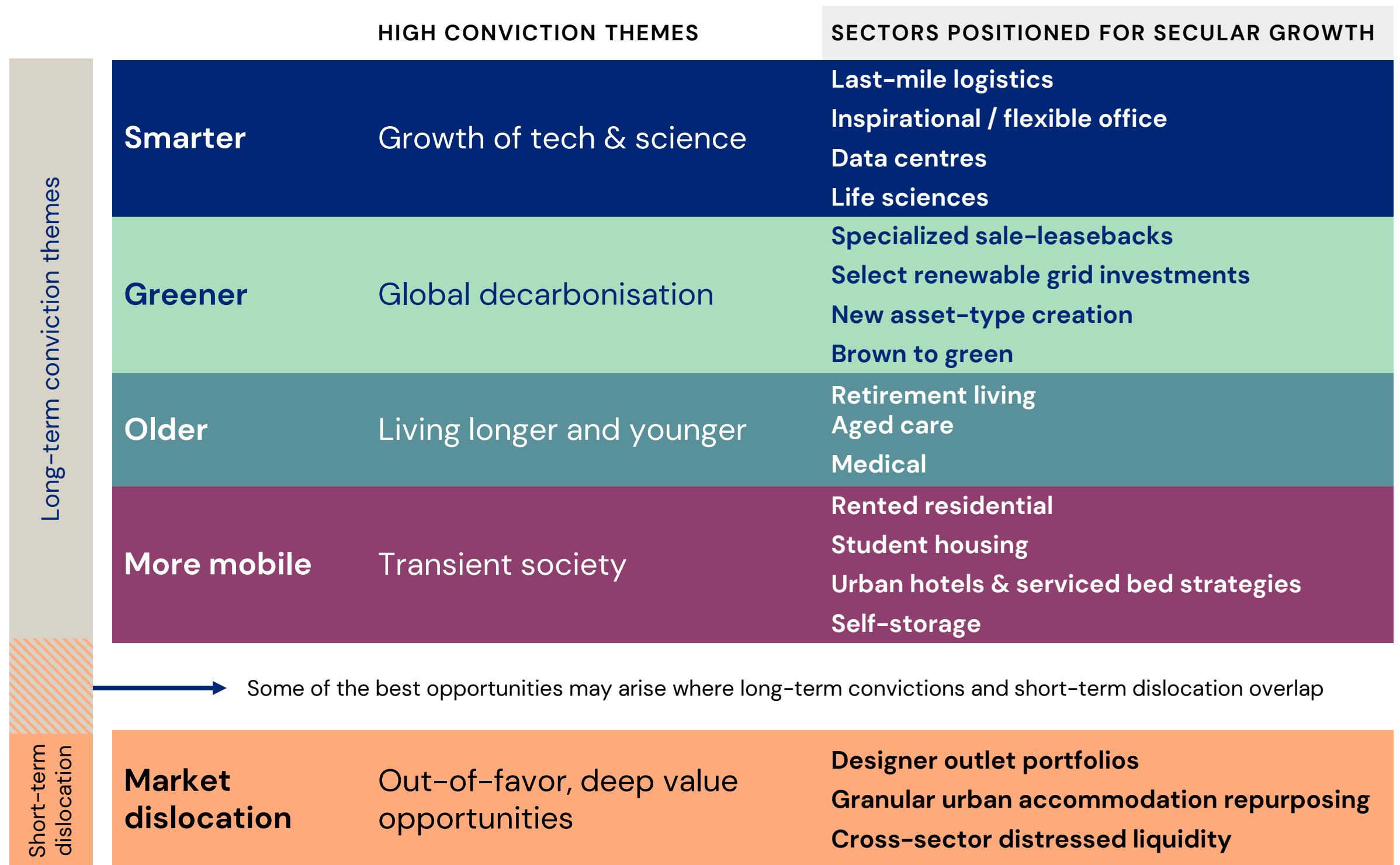
- INREV's annual survey of investor intentions for 2022 saw appetite for European value-added strategies increase markedly compared with 2021, with 57% of investors surveyed expressing a preference for this style on a risk-adjusted performance basis – the highest since 2008.
- However, comparing INREV's survey results with Preqin fundraising and vintage return data shows that investors' stated preferences statistically lag, rather than lead, style fundraising – suggesting a channel whereby successful fundraises increase visibility of a style, leading to higher stated investor preferences in subsequent years.
- It is entirely plausible that these stated preferences also lag fund returns, as indeed can be seen in the chart at right. Though vintage returns cannot be known during the year of the raise, it is now clear that the relative lack of capital raised for value-add funds in 2010 & 2011 saw investors miss out on the higher median return offered by those vintages. Conviction investors may therefore stand to benefit by being ahead of the pack.



Source: INREV, Preqin, LaSalle (09/22)

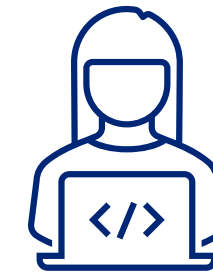
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Uncertainty is temporary, but megatrends will endure



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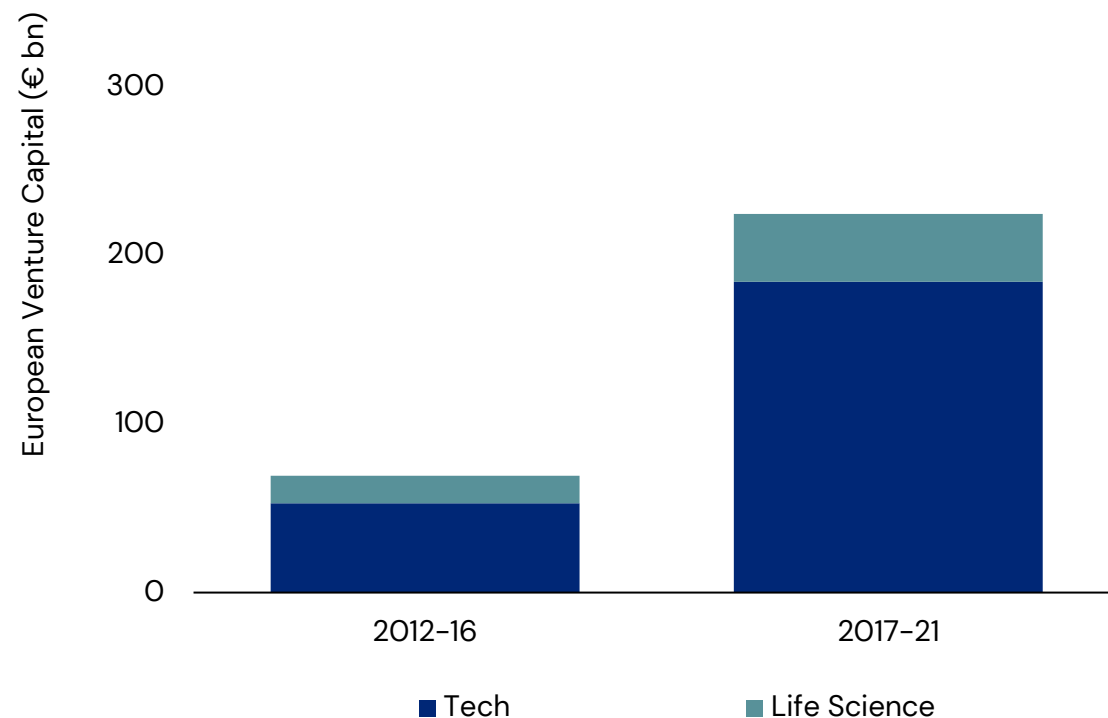
Future Europe will be: Smarter



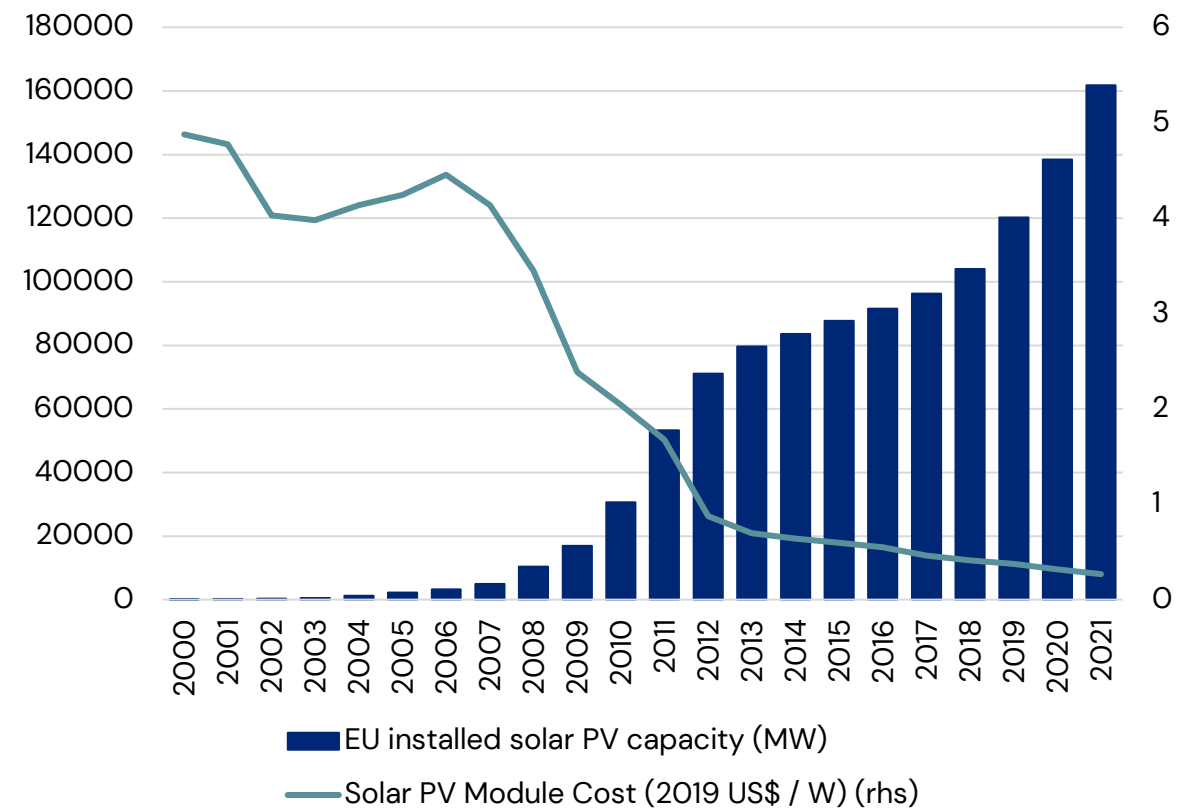
Convictions

- Though high-growth tech equities have seen acute revaluations this year, the growing fusion of the physical and virtual is unlikely to reverse
- Growth in the Internet of Things will make buildings, as well as their occupants, smarter
- Technology is a critical driver of productivity and innovation, including in the drive for a **Greener** Europe

European tech & life sciences VC funding



Global solar PV cost & installed capacity in Europe



Future Europe will need:

- Tech-rich buildings & data centres
- 'Wet' & 'dry' lab space
- Last-mile logistics
- Flexible workplaces

Source: Refinitiv, Eurostat, OWID, LaSalle (02/23)

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Future Europe will be: Greener



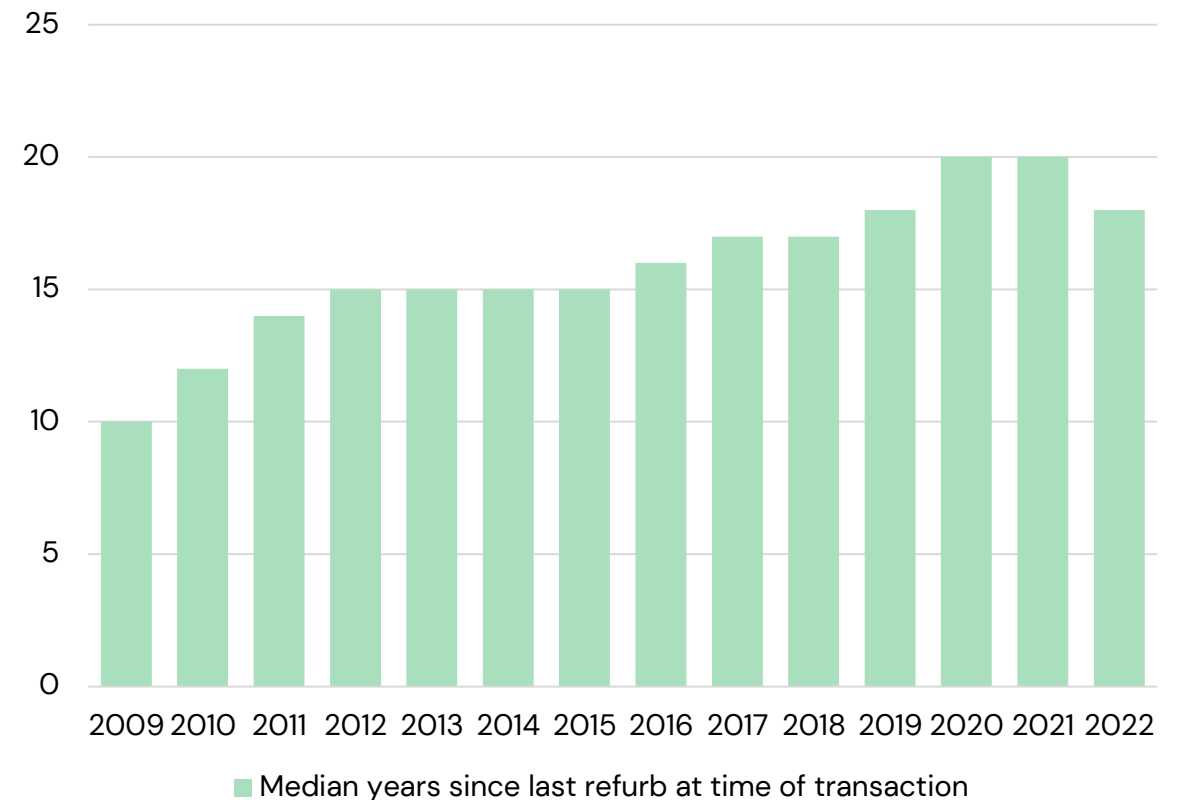
Convictions

- Europe leads the way in investor appreciation of the importance of climate action – over 80% of European investors have a decarbonisation target or aim to adopt one within three years
- However the quality of European office and housing stock is not yet compatible with these goals. The average time elapsed since last refurbishment of office buildings transacted in Europe has increased from 10 years in 2009 to 20 years in 2021.

The EU estimates that total investment capital required to **meet 2030 targets** within the European real estate sector is:

€275bn
per year through 2030

Effective age of transacted European office stock



Future Europe will need:

- **Modern, attractive, net-zero-carbon offices**
- **Battery gigafactories**
- **Efficient and professionally-managed homes**
- **Investment in renewables throughout the value chain**

Source: RCA, European Commission, LaSalle (09/22)

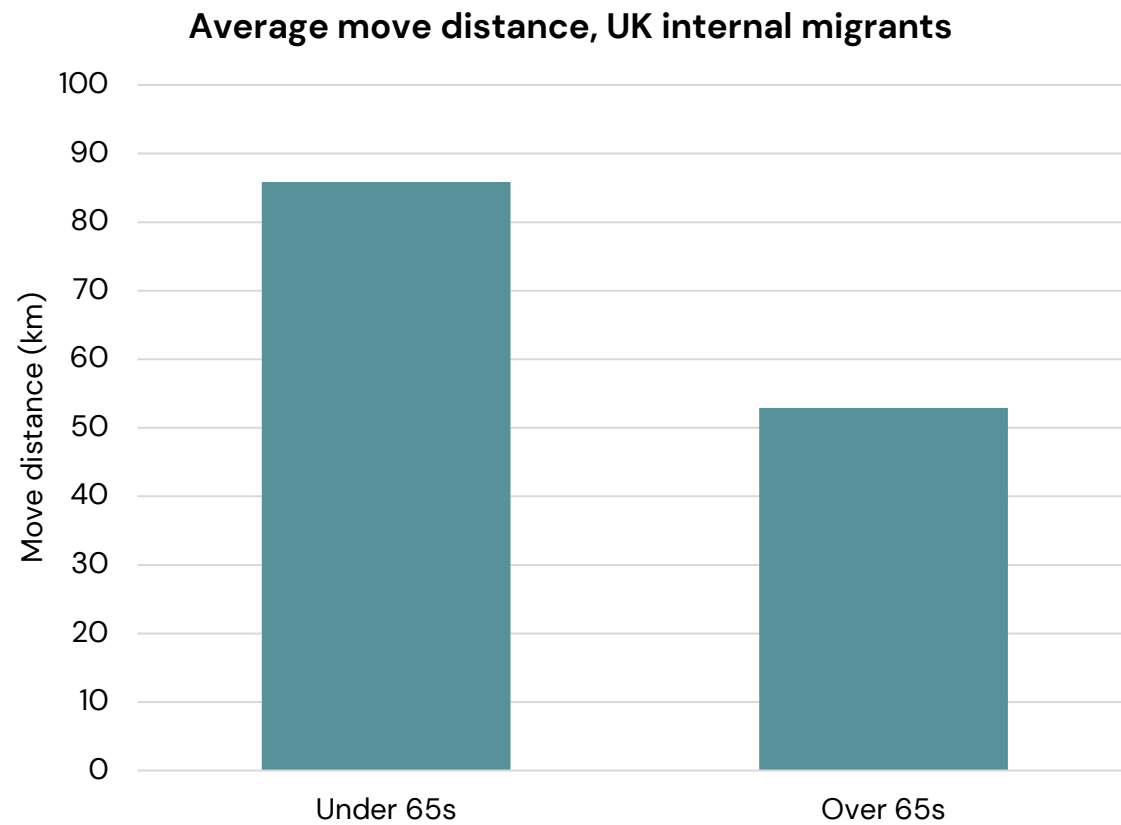
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Future Europe will be: Older

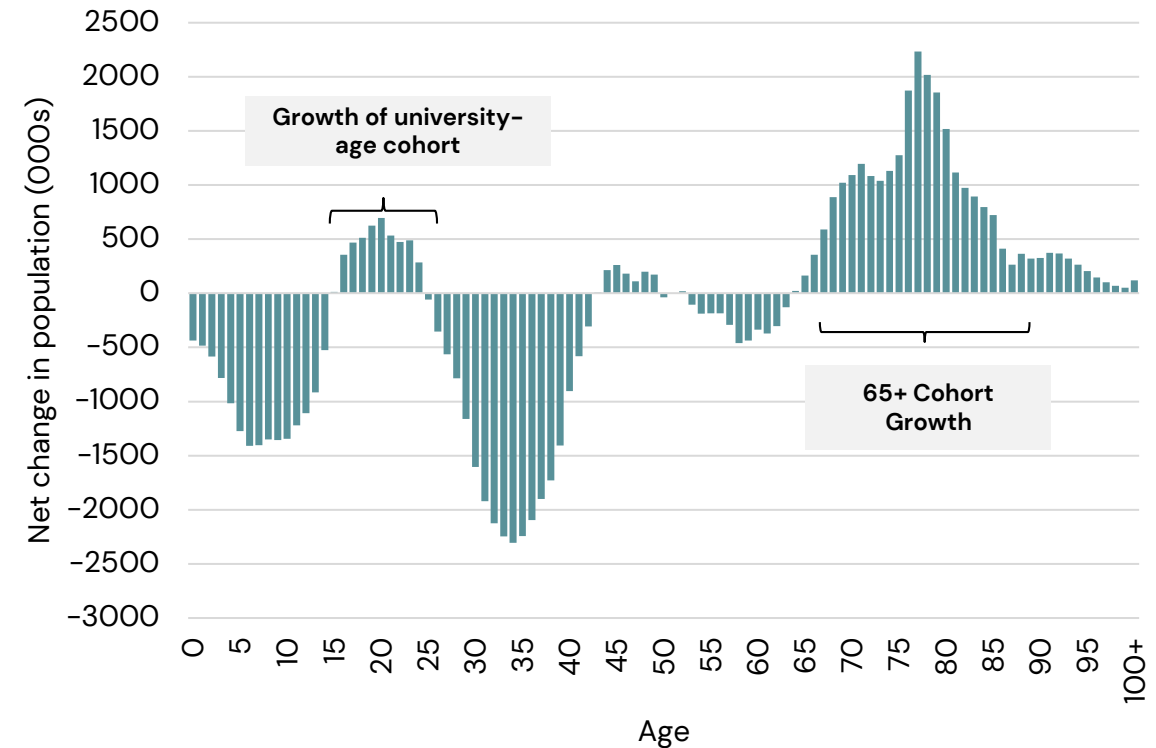


Convictions

- Europe's aging demographic is set to increase the dependency ratio each year through 2050 – however with **Smarter** development in tech, people will live younger for longer
- In the UK, our research shows over 65s **Move** shorter distances within the country – and so nearby retirement, care, and medical office facilities will be welcomed



Change in European population by year of age, 2022-2032



Future Europe will need:

- Convenient, high-quality medical office
- Nearby retirement and care facilities
- Recreational opportunities for active older adults

Source: ONS, UN, LaSalle (09/22)

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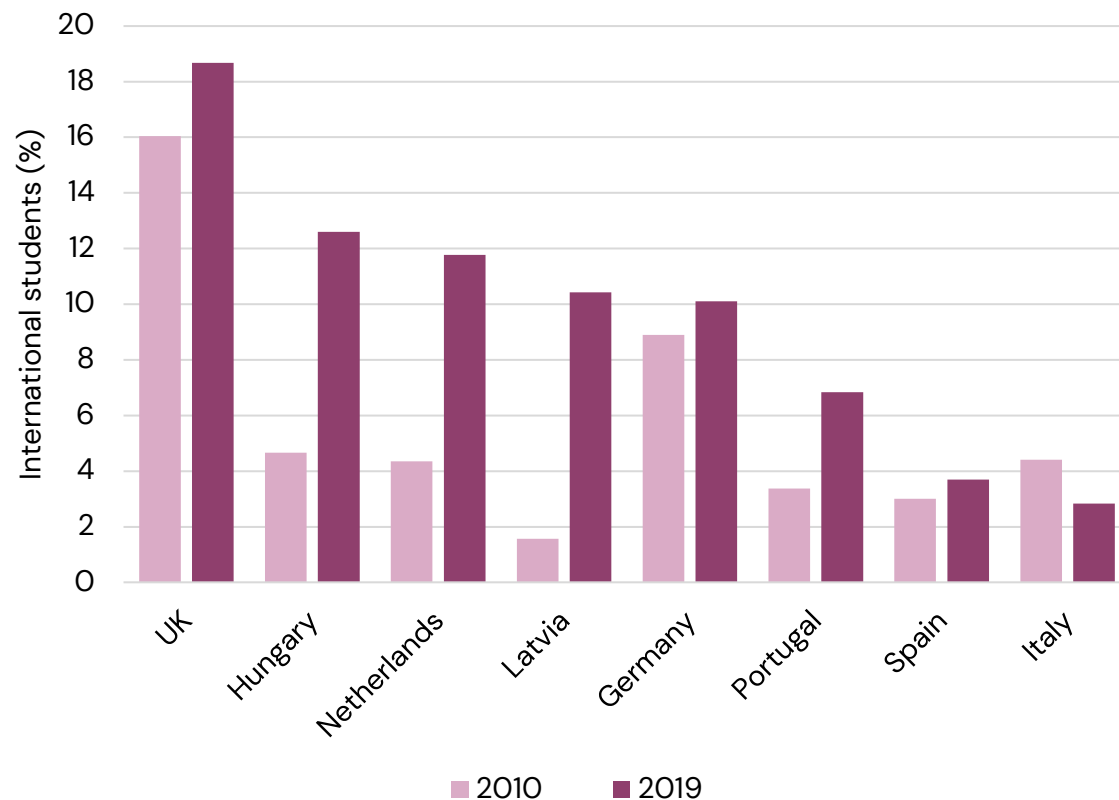
Future Europe will be: More mobile



Convictions

- Flexibility in accommodation at all stages of life will empower Europeans to access continent-wide opportunities
- Though uncertainty remains over immigration policy, fear is falling as societies integrate (right chart)
- Experience will out-compete ownership as Europeans live, work and study across borders

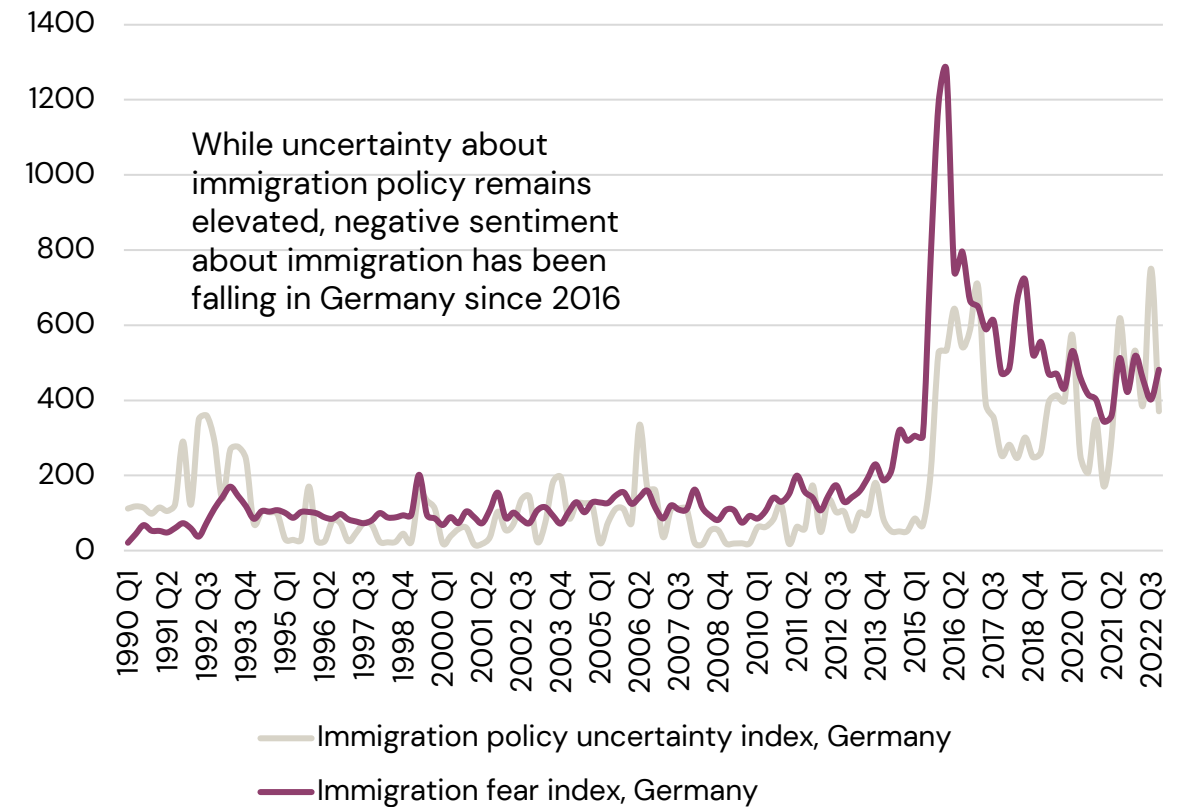
Growth in fraction of international students



Source: OECD, Economic Policy Uncertainty (02/23)

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Immigration policy: uncertainty and fear



Future Europe will need:

- High-quality Purpose-Built Student Accommodation
- A full range of rented residential from affordable to luxury
- Flexible urban accommodation for leisure
- Self-storage facilities

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