28 September 2023

SIOR Europe expects market corrections as work from home culture continues to affect building valuations

The European Chapter of the Society of Industrial and Office Realtors (SIOR), the leading global association for real estate brokers, has gathered market insight from its members on the outlook for the real estate sector in key markets across Europe. In summary, the market is facing many challenges including financing, reduced capital market values, rising inflation and interest rates, spiralling construction costs, while meeting the demands of ESG requirements, and an entirely new post-pandemic office market.

However, while the market remains cautious and risk averse, with due diligence a key priority, most agree that the worst has passed and expect transaction volumes and activity to pick up as we go into the second half of 2024.

Germany

By Thorsten Wolf SIOR of JLL, Tobias Schultheiß SIOR and Armin Voellnagel SIOR of Blackbird Real Estate GmbH, Guido Nabben SIOR of Anteon.

The German real estate market, especially logistics, is experiencing stable rents due to limited availability. However, the investment and letting markets remain stagnant due to factors like rising interest rates, ESG compliance requirements, and a slow adjustment of pricing expectations between buyers and sellers in Germany.

ESG compliance is a top priority, impacting property pricing and potentially stranding assets. Office and hotel property values are softening, while industrial property values remain steady, and retail has reached its lowest point. Construction costs are gradually decreasing, and hybrid working models are reshaping office space demands.

Our members are optimistic about a market pickup in Q3 2023, but uncertainties like inflation and rising interest rates may still limit transactions, particularly in office spaces, as seen in the first half of 2023 alongside. Hybrid work models are further reducing office demands, leading to rising prime and average rents in favourable locations, such as city centres. Industrial and logistics assets remain attractive due to excess demand and rising rents. Supply chain disruptions and increased construction material costs have impacted development projects.

Major changes since before COVID-19 include the acceleration of hybrid and remote work, the surge in e-commerce affecting logistics, and a heightened focus on ESG considerations in real estate development. Global investors are cautious, while domestic investors wait for prices to correct and stabilise. More real estate opportunities are expected in Q3 and Q4 2023, with a potential increase in deals by Q2 2024 as pricing gaps are addressed.

UK

By Anders Horwood of Carter Jonas LLP, Fergus Laird SIOR of Naylor Gavin Black, Mark Trowell SIOR of Gerald Eve, Charles Thompson SIOR of Farebrother and CORFAC International, and Christopher Aquilina SIOR of Spring 4.

The real estate market has slowed down from the highs of the late 2021 / early 2022 period, and there is a general flight to quality across the leasing market, but rents have continued to increase albeit at a slower rate.

The market is facing challenges due to limited availability of multi-let, mid or large-sized spaces caused by build cost inflation and yield shifts and this has led to increased demand for build-to-suit options. ESG considerations, along with EPC ratings, are gaining importance among occupiers and are expected to continue growing.

While there's a rising demand for last mile logistics, the demand for out-of-town industrial spaces, especially in the Northeast, is weakening. Cost inflation is stabilising, thanks to improved organisation of supply chains by large developers. However, leasing flexibility is on the rise, with shorter leases and more frequent break options becoming commonplace.

Ultimately, the investment market is anticipated to undergo a significant correction in the next six months, potentially causing a 20% drop in property values in some areas. Debt is a major concern, especially for heavily leveraged groups, and there's a widespread effort to cut costs.

The new generation of office buildings emphasises wellness, energy efficiency, sustainability, and a blending of work and home environments. Responsible businesses are incorporating these features into their accommodation strategy to support their return to the office, recruitment, productivity, wellness, and environmental and social policies. However, the year ahead is expected to be challenging for trading investment properties, with uncertainty regarding pricing changes and hopes for decreased inflation and interest rates later in the year.

France

By Solly Gubbay SIOR of Solly Gubbay Consultants, and Guillaume Turcas of Faro Capital Partners.

The current French landscape is marked by decreased occupier demand, notably in offices, and slightly lower demand in industrial and logistics sectors. Capital market values have experienced a significant decline ranging from 10% to 40%, with investment liquidity down by up to 60%. Hybrid working, comprising 15% to 20% remote work, is anticipated to persist, affecting office space preferences, notably higher quality and closer to central business districts. Construction costs have risen by at least 10%, in line with inflation.

ESG considerations are increasingly influential for prime corporate tenants, necessitating substantial capital expenditure to retrofit properties for reduced carbon emissions. Hybrid working is contributing to increased vacancy in suburban offices while bolstering resilience in industrial, logistics, and CBD office markets. The anticipation of higher interest rates and inflation is expected to dampen growth and reduce real estate investment allocations.

The foremost challenges facing the sector are finding an optimal hybrid working/office presence balance, grappling with higher interest rates negatively impacting capital market liquidity, and dealing with valuation concerns for REITS and open-ended funds.

Interest rates are expected to rise before inflation is effectively addressed, leading to sustained sluggish growth. While resembling a classic real estate bear market, particularly in the office sector, it is not viewed as a systemic crisis like the subprime mortgage crisis. There is a growing appeal and liquidity in alternative real estate asset classes such as retirement homes, medical clinics, hotels, co-living spaces, student housing, and life sciences properties.

Netherlands

By Eric Annaert SIOR of Colliers.

The current market is challenging, characterised by stable investment and property values, despite the tough market conditions. Construction costs are notably high, posing difficulties in closing deals. There's also a decrease in investment volume due to a lack of available products and uncertainties stemming from market conditions and regulations. Clients are primarily grappling with insufficient available products for investment and the need for upgrading or transformation without adequate capital. However, there's an expectation that the market will eventually regroup, leading to an increase in investment volume.

-Switzerland
By Martin Grenier SIOR of SPGI Zurich AG.

Interest rates have risen as expected, leading to some price corrections in transactions. The market is currently favouring buyers due to increased supply.

In terms of investment and property values, a soft landing is expected, with price corrections of around -10%. The relevance of office location and quality has increased, and remote work is becoming more common in some industries.

Industrial uses are moving away from city centres, while the logistics market remains in high demand, especially for last-mile delivery. Construction costs remain high, making profitable projects more challenging.

ESG factors are also gaining importance, especially among institutional investors. The primary trend is focused on reducing CO_2 emissions through better insulation, renewable energy use, and solar panels. Social and governance aspects are less emphasised.

Interest rates have significantly increased, and asset classes like life sciences and healthcare are gaining attention from mainstream institutional investors. Housing shortages in city centres are driving residential rents to unhealthy levels, particularly in Zurich.

Higher debt costs are making alternative financing methods like sale-and-leaseback more popular. Large, listed companies are prioritising their existing portfolios over new acquisitions.

Overall, there are ongoing moderate price corrections in transactions and subsequent valuations in the market.

Nordics and Baltics:
By Max Barclay SIOR of Newsec

The real estate market has seen a significant shift in financing conditions, becoming harder and more expensive. Despite this, activity remains strong, though transactions, markets, and prices have been impacted.

The office sector is focusing on cost per employee and transforming the workspace into a meeting place, with the overall demand still high but undergoing changes. The industrial and logistics market continues to see great demand, but with some vacancies, urging the real estate market to adapt to changing logistics.

Construction costs remain high due to low competition, although there's an expectation of a declining trend. ESG considerations are becoming ever more important to the industry.

Clients are currently primarily concerned with debt and financing costs. Overall, the situation is expected to worsen before improving.

Poland
By Marek Ciunowicz SIOR of Corees Commercial Real Estate and Hanna Milczarek SIOR of BOFINK

In Poland the investment market is experiencing a slowdown due to high financing costs, leading to a drop in transactions. The private rented sector [PRS] market is gradually growing, while new office developments are slowing down.

There is a slight increase in investment yields across all sectors. In the office market, hybrid work has reduced the need for office space while, in industrial and logistics, markets are growing, especially in secondary cities and regions.

Construction costs for shell and core are stable, but fit-out and finishing costs are rising. Hybrid work and high financing costs are impacting the office market. Key client concerns include financing costs and the slow decrease of prime development properties, particularly in the capital.

The 2023 election year adds uncertainty to economic forecasts, with a potential rush of investors expected in the last quarter. PRS is anticipated to continue growing as a significant part of the residential market. The logistics sector is performing well, while the office sector is repositioning itself after being negatively impacted by the pandemic. Optimism for Polish business growth is contingent on political changes and resolution of the war in Ukraine, potentially positioning Poland as a recovery and rebuild hub for Ukraine in the coming years.

Italy
By Alberto Iori SIOR of GUIZZO srl

Tenant demand remains strong due to supply chain disruptions caused by COVID-19 and amplified by the Ukraine war. Companies seek shorter supply chains and local storage of essential goods, anticipating production delays. Investment transactions across Europe experienced a double-digit drop, especially impacting the industrial sector due to increased debt costs from central banks.

The future of property valuations is uncertain once supply chains stabilise. Adapting work roles and enhancing buildings are necessary to attract the younger generation to industrial work, and this is leading to a construction surge, focusing on upgrading to class A buildings and renovating old stock for ESG compliance and worker wellbeing. The industrial sector is embracing automation, with Genoa leading in industrial areas and automatic warehouses. Construction costs remain high and are stabilising, showing no signs of returning to pre-COVID levels.

ENDS

For more information
Vasu Guigan/Sophie Eastwood

Senior Consultant
Holistic
SIOR@holisticgroup.co.uk

About SIOR (www.sior.com)

The Society of Industrial and Office Realtors ® (SIOR) is the leading society for industrial and office real estate professionals. Individuals who earn their SIOR designation adhere to the highest levels of accountability and ethical standards. Only the industry's top professionals qualify for the SIOR designation. Today, there are more than 3,700 SIOR members in 722 cities in 45 countries. www.sior.com