EUROPEAN RESIDENTIAL INVESTMENT SURVEY

2022

Market update | The Survey | ESG update

MARKET UPDATE

Residential investment sectors are gaining traction across Europe, with the volume of capital targeting student accommodation, the private rented sector and purpose-built age-targeted housing continuing to rise.

European residential investment volumes stood at €15 billion in Q3 2021, up 28% on the same period of 2020. It takes year-to-date investment to €50 billion.

Institutional investment into residential assets, encompassing student housing, multifamily and single family rental, co-living and seniors housing, has accounted for 25% of all real estate investment by value across Europe so far in 2021, only behind offices. Ten years ago, the residential sector accounted for just 10% of all European acquisition activity.

This uptick in investment has been underpinned by the defensive characteristics of the sector, which have been on display during the last 18 months, as well as investors' growing comfort level with exposure to more operational real estate.

With inflation on the rise and bond yields at historic lows, the defensive benefits of investing in beds are set to continue as investors look to rental income as a hedge against inflation.

€15bn

Invested in residential assets across Europe in Q3 2021, taking year-to-date investment to €50 billion

Germany was the largest market for residential investment in Q3, capturing 39% of total European investment in the sector, followed by the UK, Demark, Sweden and France.

Cross-border capital, meanwhile, has accounted for almost half (46%) of purchases so far, up from 41% during the whole of 2020.

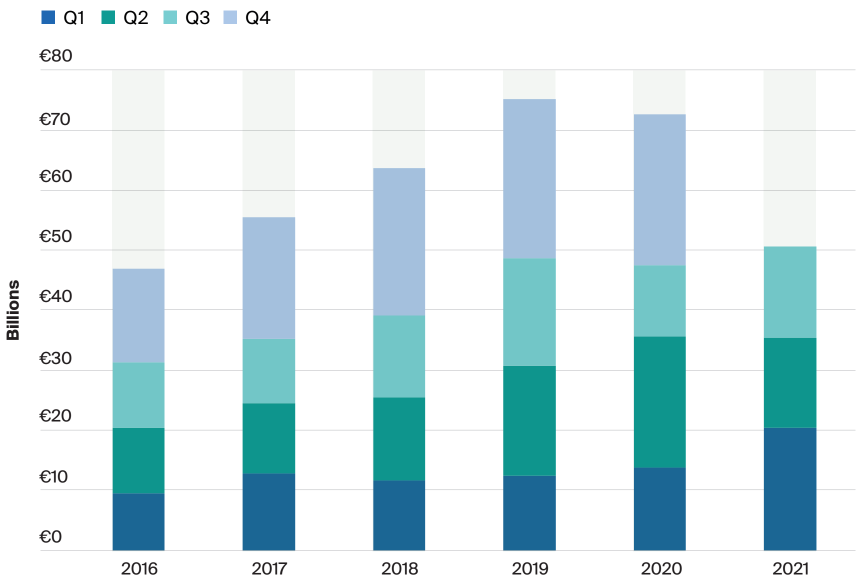
As governments continue to gradually lift Covid-19-related restrictions and cross-border mobility improves, we expect pent-up investor demand for European property to translate into a further rise in transaction activity in 2022 and beyond.

This view is supported by our survey of 22 institutional investors currently active in the sector who, combined, currently account for €64 billion in residential assets under management across Europe. The results suggest they plan to invest a further €19.5 billion in 2022 and €87.5 billion over the next five years.

25%

Residential investment as a proportion of total European CRE investment, up from 10% in 2011

EUROPEAN RESIDENTIAL INVESTMENT VOLUMES

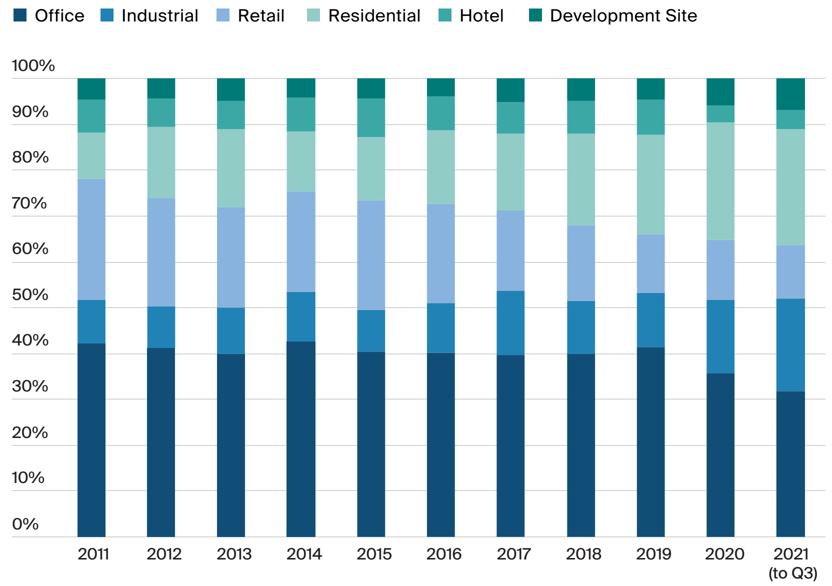


Source: Knight Frank Research / RCA

EUROPEAN RESIDENTIAL INVESTMENT SURVEY 2022

RESIDENTIAL TAKES A BIGGER SHARE OF EUROPEAN REAL ESTATE INVESTMENT

% of total investment



Source: Knight Frank Research / RCA

> "Respondents to our survey currently account for €64 billion in residential assets under management across Europe. They plan to invest a further €87.5 billion over the next five years."

A STRONG ECONOMIC RECOVERY

In October, the IMF revised up its forecast for GDP growth across the Eurozone to 5%, from 4.6% previously. A more positive outlook reflects the recovery seen in both business and consumer confidence as restrictions are lifted. In particular, France and Italy saw their prospects for 2021 improve.

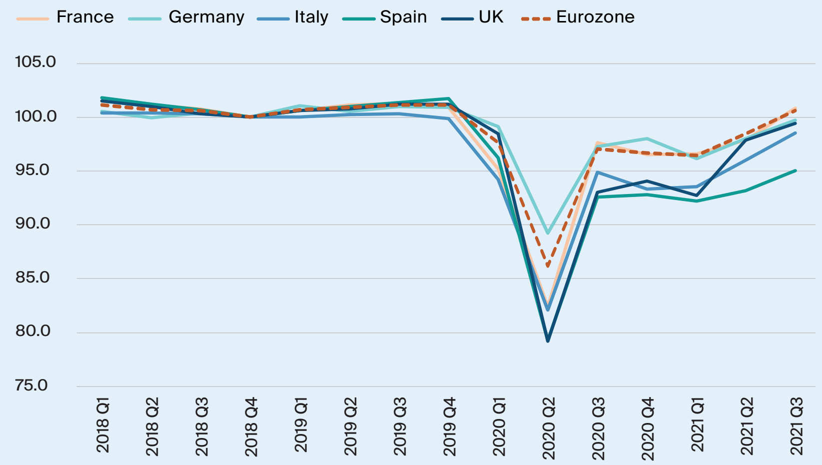
While the Eurozone economy is expected to experience above-average growth over the coming quarters, inevitably momentum will slow on the back of problems affecting global supply chains and the sharp rise in inflation in recent months.

Indeed, inflation has been climbing across the globe and Europe is no exception. Inflation rose to 4.1% in October, its highest level since 2008 (although it is higher in Germany and Spain).

For now, the ECB, unlike US and UK counterparts, has reiterated its commitment to keep rates lower for longer, citing an expectation that inflation will be transitory in nature. Current projections are that it will peak at 3.1% in the fourth quarter of 2021 before declining to an average of 1.7% in 2022 and 1.5% in 2023.

GDP REBOUNDS STRONGLY

Rebased 100 = Q4 2019



Source: Knight Frank Research / Oxford Economics

THE SURVEY

The Knight Frank European Residential Investment Survey represents the views of 22 institutional investors currently active in the sector who currently account for €64 billion in residential assets under management across Europe

Key findings from the survey

Currently, just 18% of the investors we spoke with invest across all the residential investment sectors in Europe. This is expected to rise sharply to 45% by 2026.

Collectively, respondents to our survey plan to allocate a further €87.5 billion to the European residential investment sector over the next five years.

Germany, the UK and Spain top the list as the three countries expected to have the best prospects for investment. However, the number of areas on the 'watch list' for investors is growing.

Operational residential real estate has proven to be resilient despite wider macro-economic uncertainty, with data suggesting that both occupancy and rent collection levels have stayed remained high throughout the pandemic.

In the UK, for example, our survey of some of the biggest investors in multifamily found rent collection levels have stayed above 95% since March 2020. This resilience is due to strong underlying fundamentals. Affordability and increasing urbanisation, as people move for work and study, continues to drive demand for rental accommodation, whilst ageing populations mean there is a need for purpose-built accommodation across age groups.

Accordingly, the sector continues to grow rapidly throughout Europe and we expect allocations to residential will increase markedly over the next five years.

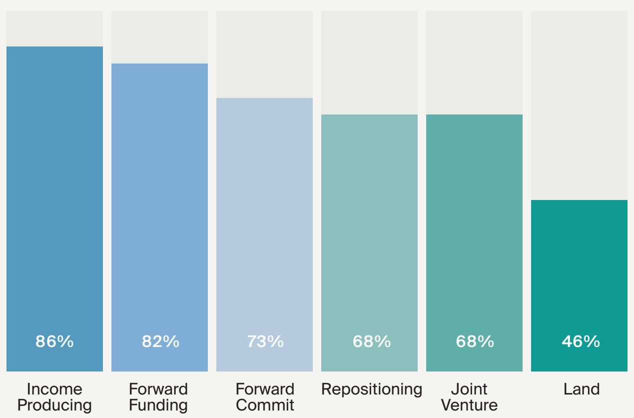
Some 91% of respondents to our survey noted they plan to significantly increase their allocation to residential over this time. A number of investors who may only be active in one or two residential sectors today said they plan to become active in additional sectors by 2026.

Currently, just 18% of respondents invest across all the residential sectors in Europe. In five years' time this is expected to rise to 45%.

This echoes our expectations for increased diversification within the residential investment market, with investors spreading their exposure across age and lifestyle groups. While there are significant differences in market drivers, there are also synergies – particularly with regards to construction and operations – which makes the decision to move across sectors more appealing.

WHICH OF THE FOLLOWING INVESTMENT PROPOSITIONS ARE YOU CURRENTLY TARGETING?

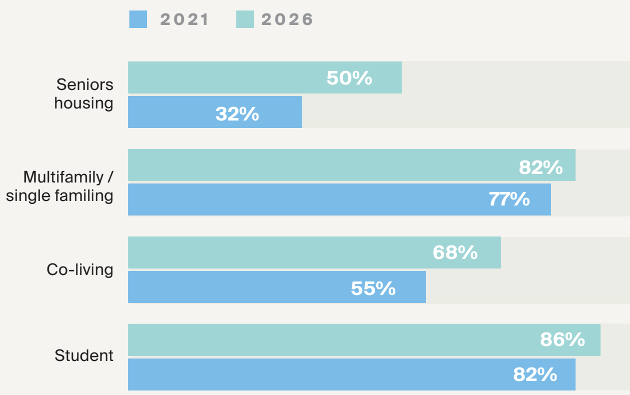
% of respondents, all sectors



Source: Knight Frank Research

IN WHICH SECTORS ARE YOU ACTIVE CURRENTLY AND WHICH DO YOU ANTICIPATE BEING ACTIVE IN WITHIN FIVE YEARS?

% of respondents



Source: Knight Frank Research

"The results of the survey echo our expectations for increased diversification within the residential investment market, with investors spreading their exposure across age groups."

Where will capital flow?

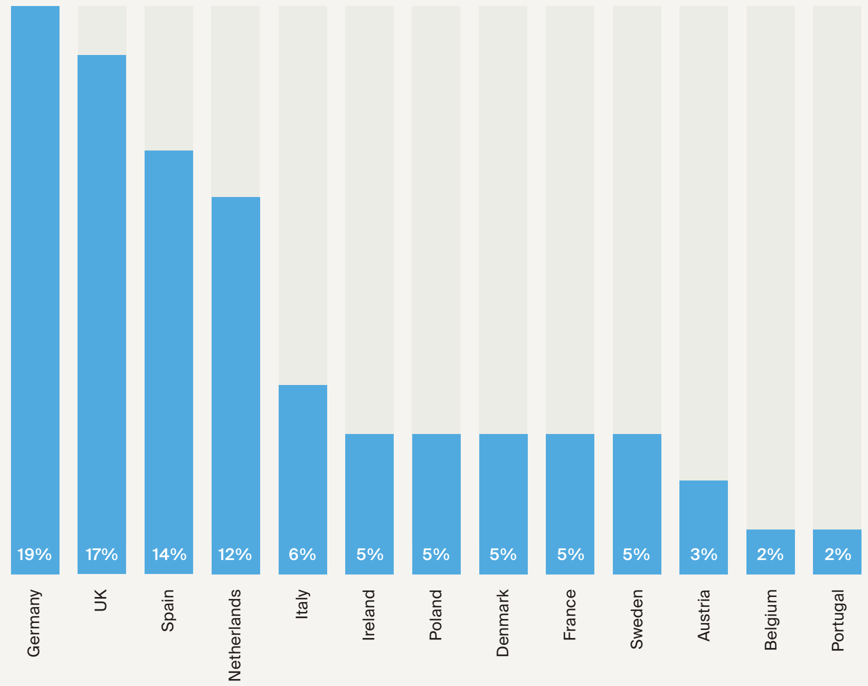
The survey respondents identified the countries where they saw the best prospects for investment over the next five years. Germany, the UK and Spain were cited most often by respondents across all sectors, suggesting an overlap of the different drivers for each sector to provide a favourable investment environment – from strong student demand, the presence of large-scale regeneration and development as well as strong employment conditions, or a lack of seniors housing units.

Newer markets also featured, with Italy, Ireland and Poland expected to attract a greater share of investment.

Some 55% of respondents indicated they believe the residential investment sector will outperform all other real estate sectors in 2022. When asked which residential sector specifically was most likely to outperform in 2022, our survey respondents suggested that student accommodation would narrowly beat the multifamily and single family rental markets.

WHERE DO YOU SEE THE BEST PROSPECTS FOR INVESTMENT OVER THE NEXT FIVE YEARS?

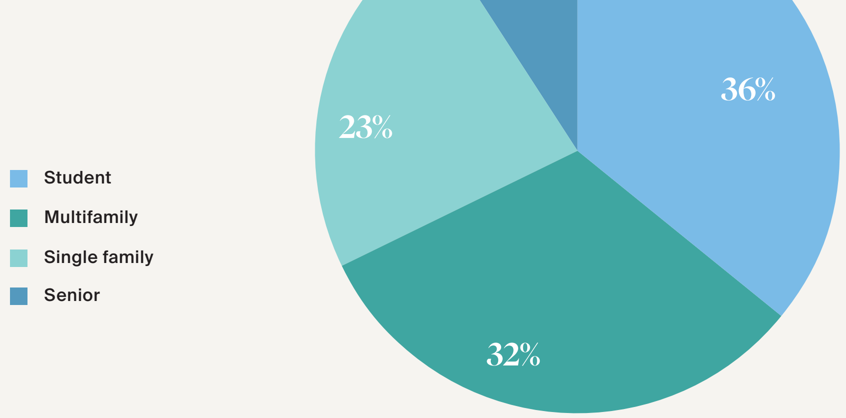
% of respondents, all sectors



Source: Knight Frank Research

WHICH RESIDENTIAL SECTOR DO YOU THINK IS MOST LIKELY TO OUTPERFORM IN 2022?

% of respondents



Source: Knight Frank Research

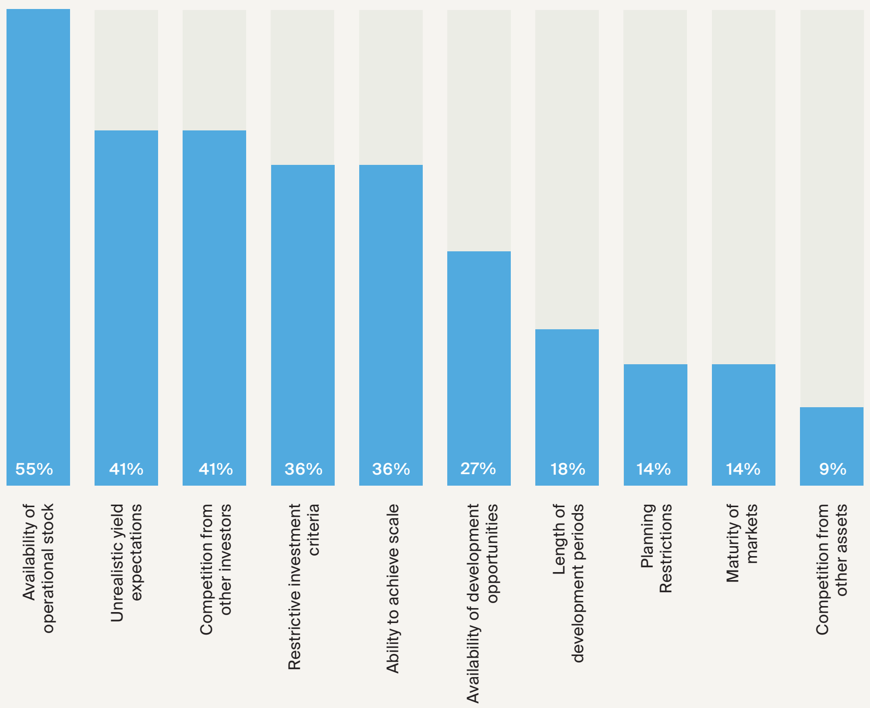
The availability of operational stock was cited as the biggest barrier to increasing investment, followed by unrealistic yield expectations and increasing competition from other investors. This is unlikely to change in the near term given the significant amount of capital waiting to be deployed. The result of this ongoing imbalance between supply and demand will be more investment into development projects, leading to some investors having to readjust return requirements.

Currently, just 46% of our survey respondents are targeting land deals, with the majority looking for income producing assets (86%), forward funds (82%) or forward commits (73%), repositioning opportunities (68%) or joint ventures (68%).

Reflecting the growth of the sectors in recent years, competition from other assets classes, maturity of markets and the length of development periods were cited as key barriers by just 9%, 14% and 18% of respondents respectively.

WHAT DO YOU SEE AS THE BIGGEST BARRIERS TO INCREASING INVESTMENT IN RESIDENTIAL ASSETS?

% of respondents, all sectors



Source: Knight Frank Research

FINDING RESILIENCE IN INNOVATION-LED CITIES

Innovation has long been regarded as an essential driver of the long-term economic growth of cities. Knowledge drives innovation, innovation drives productivity, and productivity drives economic growth. When significant, unexpected events occur, like a global pandemic, the status quo is disrupted and this often leads to new ideas and new areas of growth.

In the current uncertain environment, it will be innovation-led cities which attract and retain the population and wealth necessary for resilient, well-performing real estate markets. In real estate terms, this resilience is demonstrated by cities that can sustain tenant demand, support rental levels and capital values, and ultimately returns for investors.

Our innovation ranking comprises four components: i) quality of innovation factors, ii) innovation infrastructure, such as the number of different research organisations in a city, iii) funding and iv) drive to innovate, which looks at data around motivation to innovate. The European/Russian top 10 is listed right:

WHAT NEXT?
Read the full innovation cities research from **Active Capital**

1. London, UK
2. Cambridge, UK
3. Paris, France
4. Berlin, Germany
5. Zurich, Switzerland
6. Munich, Germany
7. Stockholm, Sweden
8. Oxford, UK
9. Moscow, Russia
10. Brussels, Belgium

Regulation and affordability top risk factors

The residential sectors in major urban centres are characterised by a structural undersupply of housing, which has underpinned rental growth over the past few years.

The other long-term trends that have underpinned the residential sector's ascent are also unchanged, despite recent events. European cities continue to grow with the share of people living in urban areas outpacing overall population growth.

Elsewhere, shrinking household sizes and rising house prices have been driving demand for rental accommodation. Data from the OECD suggests that nearly 80% of housing markets within the European Union have seen house price-to-income ratios widen over the past five years.

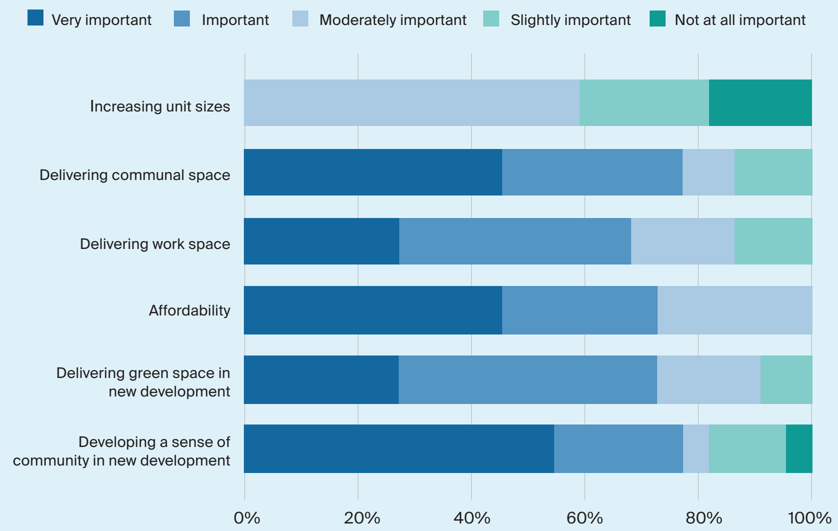
There are perceived challenges though. Changing regulation, including those linked to zoning and tenancy rules, and rent controls were flagged as potential risks, while affordability has also become a critical issue in many markets. Rising development and operational costs are also likely to be impacting on viability.

POST-COVID DESIGN CONSIDERATIONS

Changing tenant requirements post-pandemic will have an impact on scheme design and business strategy. Demand for more communal and outside space, a place to work from home as businesses embrace remote working and the curation of community within new developments are all expected to rise in importance. However, changes to scheme design will need to be balanced against the cost and viability considerations flagged as potential risk factors in our survey.

HOW IMPORTANT ARE THE FOLLOWING FACTORS IN INFLUENCING SCHEME DESIGN AND BUSINESS STRATEGY, POST-COVID?

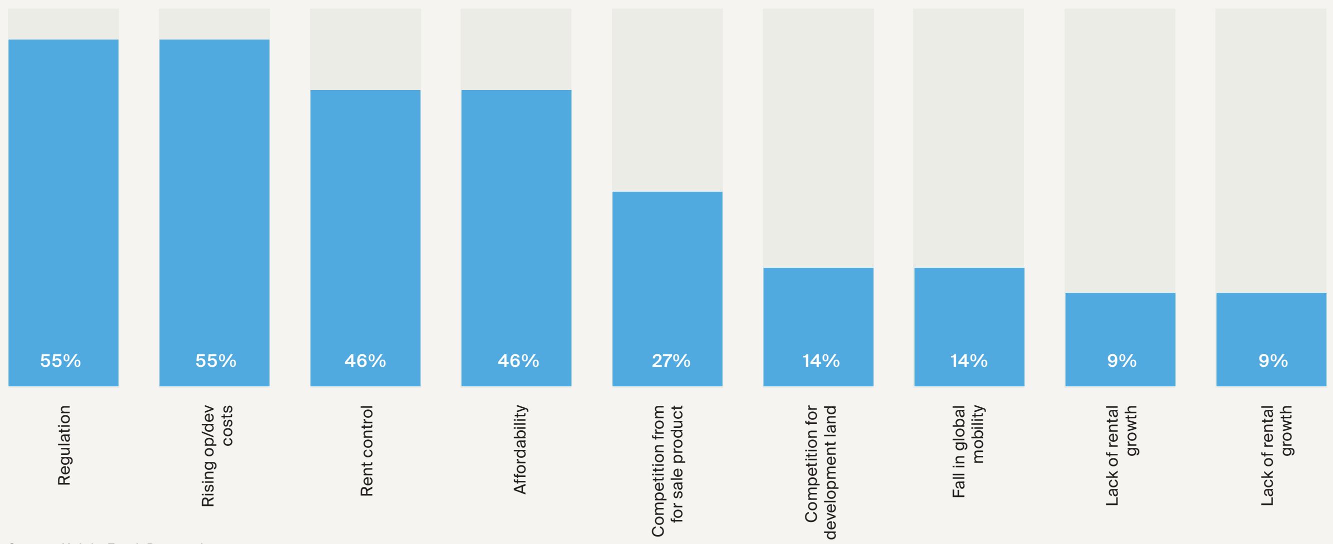
% of respondents, all sectors



Source: Knight Frank Research

WHAT DO YOU SEE AS THE BIGGEST RISK FACTORS FOR RESIDENTIAL ASSETS?

% of respondents, all sectors



Source: Knight Frank Research

GOING GREEN

Considerations around ESG (environmental, social and governance) have risen up the agenda, with sustainability credentials now front and centre of business decisions.

> "Half of respondents to the survey agreed that buildings with good ESG credentials would drive a value premium for assets."

Some 68% of respondents to our survey 'strongly agreed' when asked whether ESG is driving strategic decision making.

The survey indicates that the driving force behind demand for green buildings is coming from investors, with 86% of respondents saying this group was 'very important' when it came to decisions around ESG. This was followed by regulation at 55% and occupiers at 27%.

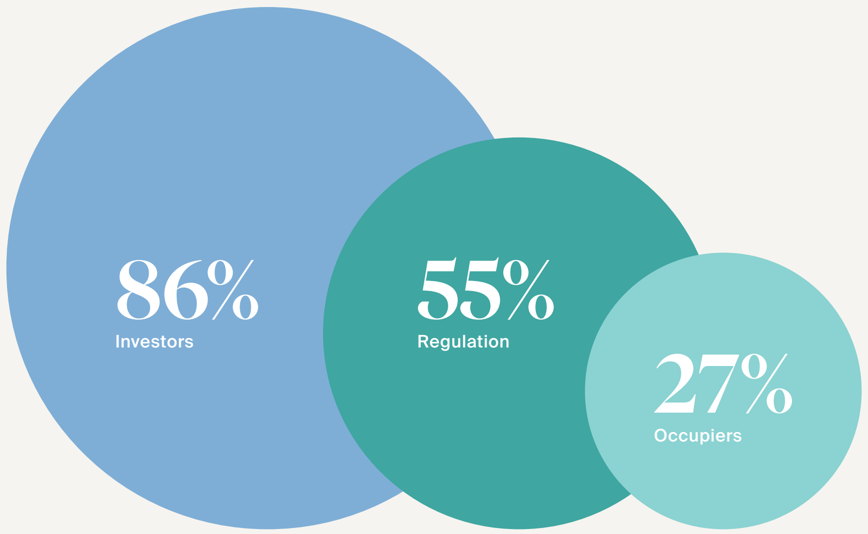
As more and more investors consider ESG as a key criteria in underwriting investment, demand and therefore the liquidity of buildings with green ratings is likely to increase.

Green-rated buildings are more likely to be future-proofed against potential legislative changes, as governments embed carbon targets into law, as well as to shifts in tenant sentiment and preferences.

Longer term, this may also drive value. Some 50% of respondents said they strongly agreed that ESG credentials would create a value premium for assets.

HOW IMPORTANT ARE THE FOLLOWING IN DRIVING THE ESG AGENDA?

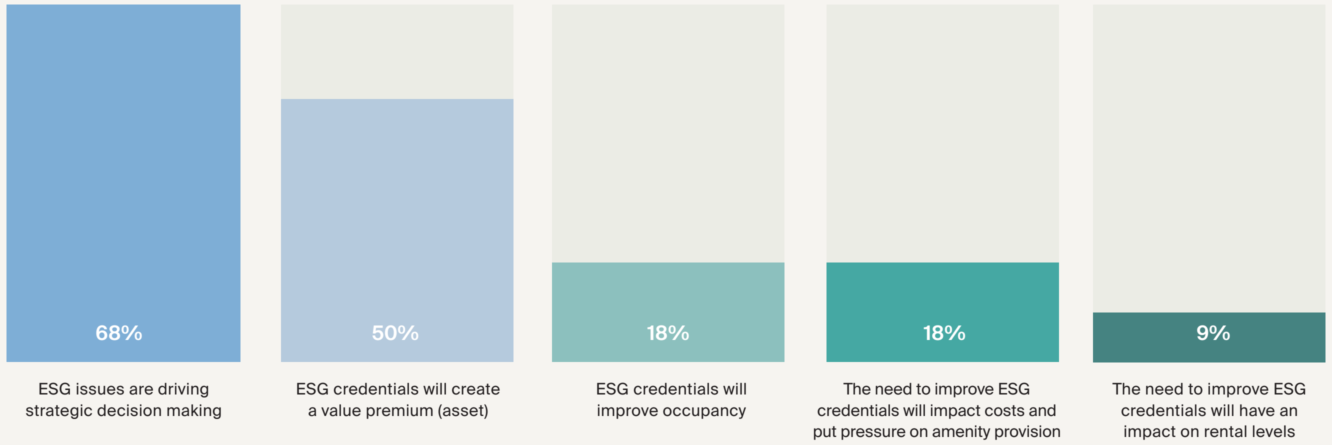
% of respondents replying 'very important'



Source: Knight Frank Research

TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENTS?

% of respondents who 'strongly agree'



Source: Knight Frank Research

WHERE ARE EUROPE'S MOST SUSTAINABLE CITIES?

First published in our *2021 Active Capital report,* the aim of our Sustainably Led Cities research is to help investors understand how the cities they are investing into might influence their benchmarking and risk outcomes.

The research focusses on the environmental rather than social aspects of a city's sustainability, distilling over 500 variables and scoring their emissions trajectory; carbon mitigants; climate risks; and urbanisation pressures, which can be combined into an overall sustainably-led cities score.

Based on our unique index of the considerations most applicable to real estate investors, London, Paris, Moscow, Madrid, and Berlin sit as the top five European/Russian sustainably-led cities for real estate. These cities benefit from a range of factors, such as declining carbon emissions per person; well-developed public transport networks; and a relatively high number of green-rated buildings.

WHAT NEXT?
Read the full Sustainable Cities research from **Active Capital**

1. London, UK
2. Paris, France
3. Moscow, Russia
4. Madrid, Spain
5. Berlin, Germany
6. Stockholm, Sweden
7. Saint Petersburg, Russia
8. Oslo, Norway
9. Hamburg, Germany
10. Brussels, Belgium

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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