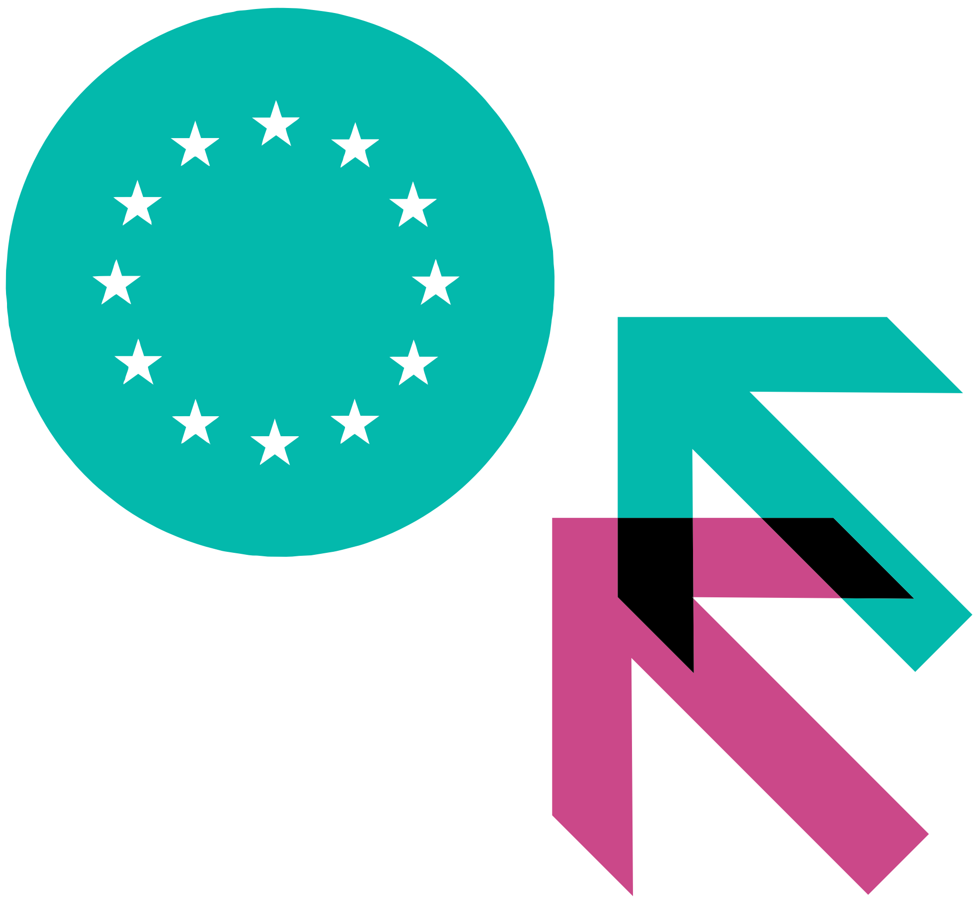
THE FUTURE IS...EUROPEAN?



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Even as the US has exported trends that have transformed global property markets, several key trends originating in Europe are likely to shape property in the US and globally in the years ahead.

The opportunity to take ideas and best practices from one part of the world and implement them in another is, alongside diversification benefits, one of the great advantages of investing real estate capital across borders. Cyclical and secular themes tend to go global, albeit with leads and lags. Having a global perspective can give an investor an early-mover advantage over other players.

Historically, a common (but not exclusive) pattern has been for concepts to debut in US before emerging elsewhere. This was mirrored in my own career trajectory, which was shaped by the export of American business models. I moved from Chicago to London in 2009, and later to Hong Kong, to help my colleagues implement strategies in sectors that were established in the US but had been nascent elsewhere, such as multifamily apartments and self-storage. LaSalle has long tracked these differences in sector institutionalization and maturity on its "Going Mainstream" framework.[1]

The flow of ideas from the US continues, as evidenced by its leading example in the maturation of bourgeoning sectors, such as life sciences and single-family rental. But we are also seeing a growing "reverse" flow, as several key trends that are especially advanced in Europe are likely to shape property in the US and globally in the years ahead. For example, sustainability standards and asset repurposing are arguably trends for which it makes sense to look to the European example for clues on how they might play out in the US.

DO AS THE AMERICANS DO—A WINNING STRATEGY?

American leadership in global property trends goes back at least to the mid-1990s, when a cohort of investment bankers moved from New York to Europe to help clean up non-performing loans from European bank balance sheets. Aided by European political integration, they kicked off a process of breaking down the barriers between once siloed domestic property markets. This is well chronicled by my friend Andrea Carpenter in her book, *High Rise and Fall: The Making of the European Real Estate Industry*. Many of the leading investment managers in Europe, including my firm LaSalle, have roots in this story.

A common thread running through many of the real estate ideas imported to Europe from the US is the diversification of the investable universe into new property types. Build-to-rent (BTR) residential and purpose-built student accommodation (PBSA) are European terms for concepts that originated in America. Investors who took early positions in these sectors (and other imports) in Europe were rewarded for being leaders.

Some secular trends in the US have also been harbingers for shifts in Europe. Take the growth of e-commerce. Americans' adoption of online shopping took off earlier than in Continental Europe. This helped explain the sustained liftoff of long-stagnant logistics rent growth in the US around 2015, even as industrial rents in Europe remained flat for years longer (they only surged around 2021).[2] With so many examples to point to, it seems that a great way to succeed in European property investing has been to import ideas from America.[3]

AMERICA'S FUTURE LOOKING A LITTLE MORE EUROPEAN

For a range of reasons, including historical and political factors, there now appear to be several themes on which European property markets are leading those in North America. Investors in the US real estate looking for resilient investment strategies would be wise to take note of this "counter flow" of potential investable themes. There are at least four important examples of this:

#1: Regulation and Pricing of Carbon Transition Risk

Europe leads in the *regulation and pricing of carbon transition risks* in real estate. Green Street Advisors has developed a "green regulation score" that is intended to capture the aggregate degree of government regulation of building emissions. By this measure, the most tightly regulated US cities (New York City and Washington, DC) are roughly tied with the least regulated major European country (Italy). The highest score of any country (the Netherlands) is more than four times higher than the GDP-weighted US average.

The federal structure of the US government, along with significant ideological divisions, means that significant variation in the degree of green regulation will likely persist at the state and city level. But policies such as New York City's Local Law 97, which taxes building carbon emissions, may be a sign of things to come for many US metros.

But regulation is only one piece of the overall "green premium" topic. Greater tenant and investor discernment between buildings with different green credentials in Europe is part and parcel of higher sustainability awareness. Europe leads in the transparency of green factors, as illustrated by divergences in the sustainability transparency sub-scores in the JLL/LaSalle Global Real Estate Transparency Index (GRETI).[4] This means that, at present, we see a deeper and broader opportunity for brown-to-green strategies in Europe than the US. But strategies that take advantage of green premiums should be expected to become more important in many US markets in the years ahead.

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#2: Climate-Resistant Infrastructure

Greater European awareness of climate mitigation also carries over into differing progress on climate adaptation. As noted in a 2022 joint LaSalle and Urban Land Institute (ULI) study, "How to Choose, Use, and Better Understand Climate-Risk Analytics"[5], investors are grappling with a deluge of new data on physical climate risks. These data highlight a large number of cities facing risk from rising sea levels, especially when factoring in the possibility of storm surge. Usefully, European countries have a long history of building infrastructure protecting cities from storms and sea levels.

For example, the Dutch have been re-shaping their coastline and building levees from at least the seventeenth century. Their expertise has grown into world-leading expertise in coping with the interface of land and sea. In the late 1970s, Dutch companies helped the UK build the Thames Barrier, which today prevents high tides from causing flooding in Central London.

While climate data providers do not currently do a good job of factoring in the benefits of climate-resilient infrastructure, investors must consider the impact of this infrastructure on risk. A property located close to sea level but protected by levees and barriers is a different proposition than a wholly unprotected one. There are many US cities and towns which will face more frequent and severe flooding events if they do not build infrastructure like the Netherlands and other European countries have long done.

#3: Repurposing Assets and Mixing Space Uses

Our tracking of the post-pandemic balance of in-person versus virtual interaction points to a robust resumption of social activities such as dining out, as compared to a much weaker recovery of daily office attendance in many markets. To be successful, cities will require a vibrant mixture of live, work, and play. The monocultures of office space that characterize many parts of US downtowns are not likely to entice people back into cities. In contrast to the US, Europe has a long and deep history of repurposing assets from one use to another, and a tradition of mixing uses.

A recent and highly salient example is the sharp reduction in office vacancy rate in Amsterdam in the 2010s, as redundant office buildings were converted into housing. But those looking for use conversion to be a panacea for surging office market vacancy in the US are likely to be disappointed. Differences in planning systems and physical building footprints in Europe versus the US constrain the feasibility of change-of-use projects. However, it is likely that repurposing plays will represent an increasingly important strategy in North America.

#4: Interventionist Policies

It is a widely held stereotype that European economies are highly regulated, while the US operates on a *laissez faire* model. But recent developments suggest that American policy has become more interventionist, underscoring that, as in Europe, investors are wise to consider the property market implications of policy shifts.

The recent trio of major Federal policy bills—the Infrastructure Act, the CHIPS Act, and the Inflation Reduction Act—feel almost like French-style *dirigisme* in their scope and impact. Each has the potential to drive the location and path of economic activity, and thus influence real estate demand. In a narrower real estate context, the regulation of residential rents, a long-standing feature of many European housing markets, has increased in prevalence on the US. The impact of policy changes should never be overlooked.

Monitoring the strong, cross-border flow of ideas is likely to improve the chances of success for cross-border investors. Macro trends, cyclical patterns, and operating models tend to emerge in one part of the world, and yet eventually find applicability in others. The US has often long been at the forefront of property market trends, but there are increasingly evident themes which seem likely to flow the other way. Globally minded investors, and the global investment managers that serve them, should be strongly positioned to capitalize on these dynamics.

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ABOUT THE AUTHOR

Brian Klinksiek is Global Head of Research & Strategy for LaSalle Investment Management, one of the world's leading real estate investment managers across a wide range of investment strategies. Brian's colleagues Eduardo Gorab, Rich Kleinman, Daniel Mahoney, and Julie Manning also contributed to this article.

NOTES

[1] "Going Mainstream: Niche Property Types and Their Path to Market Acceptance," LaSalle Investment Management, February 2016.

[2] The UK, like the US, was also a leader in e-commerce adoption, and especially so in the emergence of online grocery delivery models. Logistics rental growth spiked in the UK after it did in the US, but before the rest of Europe.

[3] This is not to say that ideas flowed exclusively from the US to Europe. Indeed, US real estate industry standards have taken cues from the UK's transparent performance measurement and its dynamic valuation practice.

[4] Global Real Estate Transparency Index, JLL and LaSalle, 2002.

[5] "How to choose, use and better understand climate-risk analytics," Urban Land Institute and LaSalle Investment Management, September 2022.

REVIEWER RESPONSE

The author begins by acknowledging that 'sticks and bricks' innovation typically originates in the US and exports globally, providing astute investors with an investment and diversification edge. From his global perspective, perched in London, the author then observes that there are four "reverse themes" from Europe that might impact US real estate markets. While the US real estate exports are capitalistic in origin – how to innovate and make more money – the reverse themes from Europe originate from different sources. Both #1: Regulation and Pricing of Carbon Transition Risk and #4: Interventionist Policies are induced by regulation. These have succeeded in Europe, but the author acknowledges that fractured politics in the US may inhibit uniform implementation across states. Another key driver for both themes is "greater tenant and investor discernment" which – from this reviewer's perspective – is in its nascent stages in the US markets.

Theme #3: Repurposing Assets and Mixing Space Uses is interesting. Yes, Europe has a deep history of repurposing assets, but this is driven to a certain degree by availability of space. The analog in the US is most likely limited to dense urban settings, as opposed to large swathes of the country where space is abundant and the real estate calculus different. Lastly, Theme #2: Climate-Resistant Infrastructure is the one that might get the most attention in the US markets. This is not because the US real estate community is jumping on the climate change / ESG bandwagon, but rather because the increasing cost to the physical asset – both in terms of weather-related capex costs and unsustainably increasing insurance costs – is impacting returns. Anything that hits the bottom line surely deserves attention! Overall, the article provides an insightful look at key themes across Europe that may impact US real estate and is indeed useful to the astute investor looking to be at the forefront of change.

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