
2023

# HOUSE VIEW

European Property
Market Outlook

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# EXECUTIVE SUMMARY

We are pleased to present our **2023 European House View** This publication is produced each year and serves two essential purposes. First, it highlights our outlook for the European economy and the commercial real estate (CRE) sector as well as significant trends and opportunities. Secondly, it reasserts our investment stance before providing a forward-looking framework regarding our investment themes and strategies. The following includes several highlights from the report:

1. Persistently high inflation, and the way in which central banks are responding to it, is dominating the economic outlook. The combination of much higher inflation, the war in Ukraine, and ongoing energy price shock has increased the risk of a recession in 2023. We are in a period where the number of potential black swan events is elevated.

2. An important factor underpinning the anticipated slowdown in growth is the removal of monetary accommodation as many central banks seek to moderate high inflation. Rising interest rates mean a higher cost of capital is acting as a brake on real estate investment activity while the market is in price discovery mode.

3. CRE market fundamentals in Europe are solid, with robust leasing activity and strong rent growth. Capital markets are likely to remain under some pressure as central banks continue to raise interest rates to fight inflation. We do expect a value correction to occur that may create compelling investment opportunities beginning in 2023 and into 2024.

4. We believe parts of Europe stand to benefit from enhanced deglobalization in the intermediate-term and offers attractive risk-adjusted investment opportunities through the development of high-quality logistics properties as multi-national companies look to nearshore production and supply chains and safeguard inventory.

5. We see an opportunity to take advantage of unmet consumer and investor demand for institutionally owned multifamily housing in the UK and select European markets through developing multifamily rental homes in locations with compelling market dynamics.

6. Our conviction around "The Intersection of Real Estate and Technology" has grown even stronger in light of the ongoing market volatility. We believe investments in technology-driven strategies will continue to benefit from the combination of strong demand driven by the digital economy and limited supply.

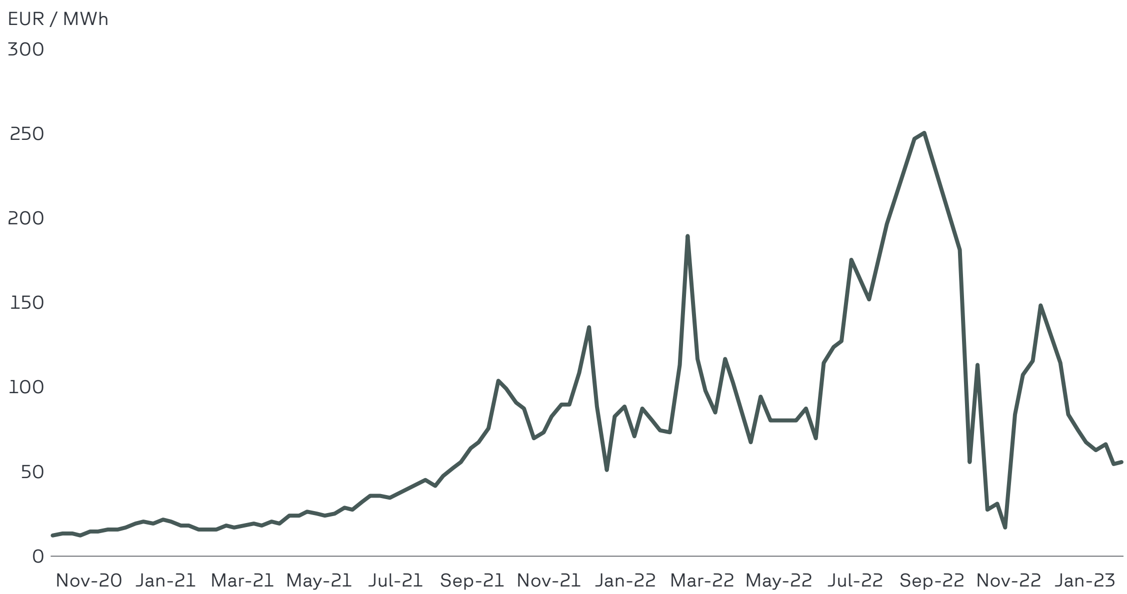
7. We believe alternative lenders are well-positioned to take advantage of real estate lending opportunities arising from a pull-back by commercial banks and a permanent change in the competitive structure of the market. More specifically, since the onset of COVID-19, a trend away from relationship banking to an intermediated market has accelerated, and efficiencies, particularly in rehab and construction lending by non-banks, are expected to be enduring.

# EUROPEAN ECONOMIC OUTLOOK

## Uncertain Economic Environment

Economic activity is experiencing a broad-based slowdown, with inflation in Europe much higher than the European Central Bank's (ECB's) target of below 2%. Russia's invasion of Ukraine, the cost-of-living crisis, and tightening financial conditions all weigh on the outlook. Beyond the substantial loss of human life and livelihoods, Russia's invasion of Ukraine has led to an energy crisis in Europe that is sharply increasing the cost-of-living and slowing economic activity. **Recession risk is elevated in Europe, where the supply-side shock from the Russian invasion has been felt most due to greater energy dependence and trade linkages.** Natural gas prices in Europe increased significantly in 2022 following Russia's invasion of Ukraine (**Exhibit 1**). More recently, natural gas prices have fallen, reflecting warmer weather, alternatives to Russian gas, and the buildup of storage. This is a positive development; however, it will take time for lower prices, if they persist, to filter their way through to consumers and industry. These challenges do not imply that a large downturn is inevitable. In many countries, the economic foundations are strong, and policymakers have scope to act. Labor markets remain tight, with relatively low unemployment rates and high levels of vacancies. **There is uncertainty in the outlook, mainly around energy prices; however, our base case assumes a relatively shallow slowdown in Europe with recovery accelerating from 2024.**

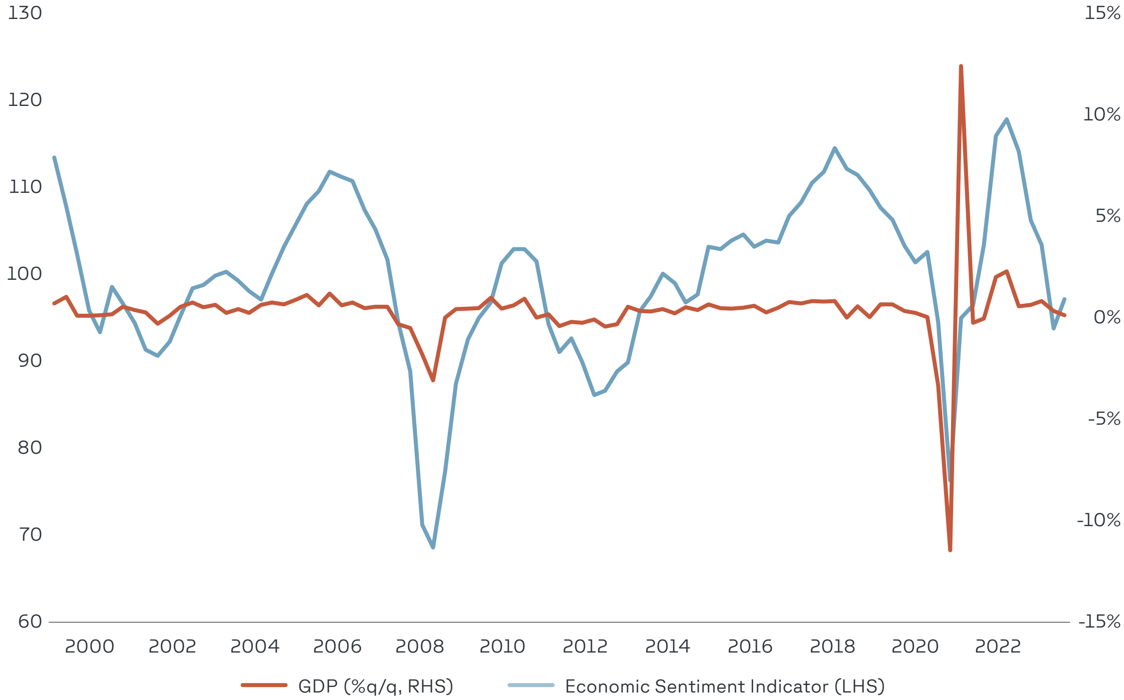
**EXHIBIT 1:** ICE DUTCH TTF GAS SPOT PRICES




Source: Bloomberg, January 2023

**Eurozone:** The main driver of future prospects is elevated inflation which is squeezing household incomes and creating headwinds for the industrial sector. While sentiment and forward-looking indicators appear to be improving, backward-looking data is more mixed. Retail sales and industrial production point to a weak end to 2022. However, sentiment gauges and the latest GDP figures suggest the Eurozone economy is faring better than expected. The Eurozone economy surprised on the upside in Q4 2022, posting growth of 0.1% quarter-on-quarter (**Exhibit 2**). Nonetheless, we remain cautious on the outlook. Even it not contracting, economic activity remains subdued, and headwinds are likely to persist through 2023. We maintain our prediction that GDP growth will stagnate this year (0.4%). Farther out, the economy is projected to grow by 1.5% in 2024.[1]

**EXHIBIT 2:** EUROZONE ECONOMIC SENTIMENT & GDP



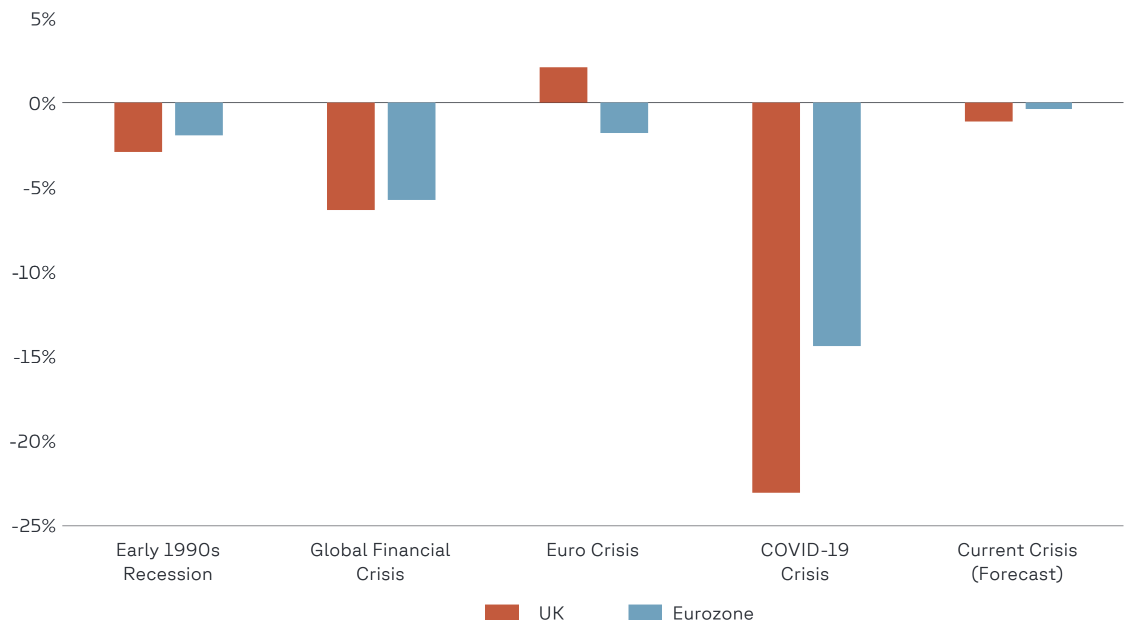

Source: Eurostat, Oxford Economics, January 2023

1. Oxford Economics. UK Economic Forecast. February 7, 2023

**United Kingdom: UK GDP growth is forecast to decline by 0.7% in 2023 as high inflation reduces purchasing power and tighter monetary policy takes a toll on consumer spending and business investment.**[2] Although the decline in natural gas prices means inflation should fall slightly more quickly, the bigger picture remains one of the UK economy enduring a relatively shallow recession, albeit deeper than the Eurozone. A substantial tightening of the government's fiscal policy means real household incomes are likely to fall further, weighing on economic activity this year. As a result, we expect consumer spending to decline until late-2023.

These current convictions shape and inform our House View as it pertains to the economy as well as the property and capital markets. While we think growth will slow, this is not of the same magnitude as during the Global Financial Crisis (GFC) when GDP fell 6.3% peak to trough in the UK and 5.7% in the Eurozone (**Exhibit 3**). In the next few sections, we will provide and update our outlook on inflation and interest rates along with the labor market. From there, we will focus on the secular trends impacting CRE investment opportunities. These factors lead to a financial climate that in many respects transcends most recent prior market periods, evolving faster and with more dynamics to assess and mitigate than ever before. Yet, leading to the emergence of potentially compelling value opportunities into 2023 and 2024 for well-disciplined and capitalized strategic real estate investors.

**EXHIBIT 3:** PEAK TO TROUGH FALL IN REAL GDP DURING RECESSIONS




Source: Oxford Economics, February 2023

2. Oxford Economics. UK Economic Forecast. February 7, 2023

## INFLATION OUTLOOK

The Eurozone saw inflation fall to 8.5% in January 2023, down from 9.2% in December 2022. The moderation in the Eurozone was driven by energy prices, which rose 17.2% year-over-year, down from 25.5% in December.[3] However, hopes that the surge in prices has peaked may be premature. **The economic outlook remains surrounded by an exceptional degree of uncertainty as the war in Ukraine continues and the potential for further disruptions is far from exhausted.**

Most of the inflation increase so far is driven by high commodity prices – primarily energy, but also food. Central banks are focused on restoring price stability, and the pace of tightening has accelerated. **We expect inflation to be lower in 2023, although the extended period of high prices in 2022 poses a greater risk of entrenchment of higher inflation.** Price dynamics are likely to benefit from favorable statistical effects; significant price increases at the beginning of 2022 will create positive base effects; which could allow for a reduction in annual inflation over the following months. We anticipate inflation will moderate at the start of 2023, but it will stay high for much of the year, averaging 4.9% in the Eurozone and 6.6% in the UK (**Exhibit 4**).

Europe's dependence on Russian oil and gas presents further risks if the war continues for an extended period, even as other countries work to supply the continent with additional natural gas. Policymakers have swiftly responded to the energy crisis and built adequate gas storage, but further disruptions to energy supplies could lead to another period of inflation. Even without new energy supply disruptions, inflation could remain higher for longer due to disrupted exports from the region for other commodities, including metals and food. **While these prices might remain elevated for some time, there is hope that they will stop increasing and thereby contribute to a steady decline in inflation throughout 2023.**

The war in Ukraine will keep uncertainty high for the near term, with the balance of risks to the downside for growth and to the upside for inflation. Given the ongoing war, there will be a need for future assessments of damage, loss, and reconstruction needs in Ukraine. A recent report estimated the cost of reconstruction and recovery in Ukraine at $349 billion. This figure is expected to grow in the coming months as the war continues.[4] Several organizations have outlined reconstruction plans of varying degrees of detail with widely different estimates of the funding needs. **What is clear is that Ukraine's reconstruction will take investment and time, with some economic reconstruction plans mentioning 10 years.**[5]

**EXHIBIT 4:** EUROZONE & UK CPI ANNUAL INFLATION


Source: Oxford Economics, February 2023

3. European Commission. CPI Inflation. January 2023
4. The World Bank. Ukraine Recovery and Reconstruction Needs Estimated $349 Billion. September 9, 2022
5. The Brookings Institution. Financing and Governing the Recovery, Reconstruction, and Modernization of Ukraine. November 3, 2022

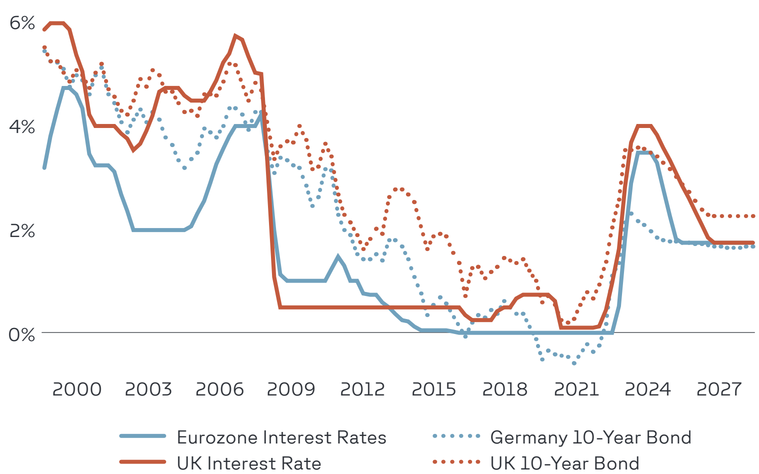
## RISING INTEREST RATES

Since July 2022, the ECB has raised policy rates by 300 basis points, from a low of -0.5% to 2.5% as of February 2023. **The rapid series of rate hikes has been the most aggressive monetary response since the early 1980s.** The ECB is expected to raise policy rates to a peak of 3.4% in 2023.[6] In the UK, the Bank of England's (BoE) focus on inflation is currently driving policy decisions, but that could change as growth slows. The BoE increased interest rates by a further 50 basis points to 4.0% at the February policy meeting. Interest rates in the UK have now risen by 375 basis points since January 2022. We anticipate a further 25 basis point rate hike in March, with the peak in interest rates now close.[7]

We do not foresee a return to the ultra-low interest rates of 2021. However, the new normal is lower than the old, pre-GFC, normal (**Exhibit 5**). **The bond market is reacting to the tightening of monetary policy, with the German 10-Year government bond increasing to 2.6% as of December 2022.** The 10-Year has since fallen back to 2.2% in February 2023 but remains elevated.[8] We anticipate the German 10-Year to remain elevated throughout 2023, as compared with the lows of -0.2% recorded at the end of 2021. In the UK, 10-Year bonds peaked at 3.7% in December 2022, up from 0.9% a year prior. We believe it will take longer for UK bond yields to settle at lower levels given the more punishing sell-off during 2022, but we do expect them to gradually fall from 2024 onwards.[9]

These expectations for bond yields align with our belief around lower relative interest rates for the long term based on structural demand from domestic and foreign institutional buyers combined with demographic factors such as the aging of the population and increasing pension liabilities. The risk of recession in 2023 further supports a continued low interest rate environment, although rates have continued to rise given the persistence of inflationary pressures in Europe.

**EXHIBIT 5:** OFFICIAL CENTRAL BANK INTEREST RATES & 10-YEAR GOVERNMENT BONDS




Source: Oxford Economics, February 2023

6. Oxford Economics. Forecast as of January 24, 2023
7. Oxford Economics, UK: Bank Rate hiked again but the peak is now close, February 3, 2023
8. Wall Street Journal. Market Data. Accessed February 3, 2023
9. Oxford Economics, Forecast as of January 24, 2023

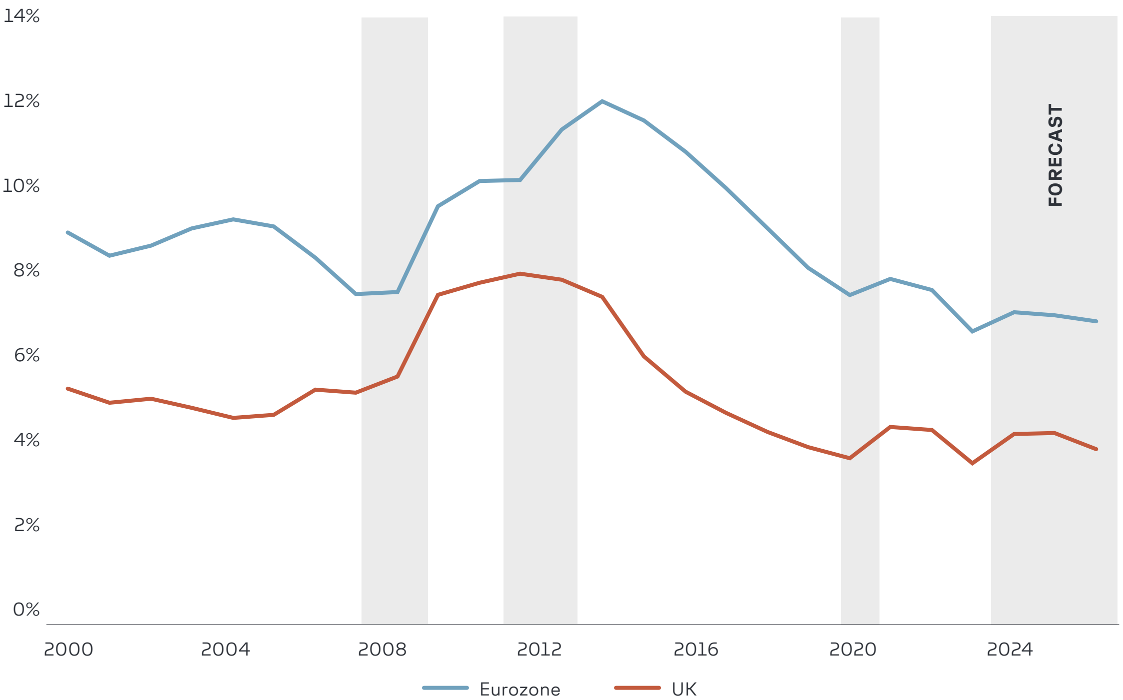
## LABOR MARKET UPDATE

The Eurozone unemployment rate remained stable compared to the previous month in December 2022 at 6.6% and has fallen from 7.0% since December 2021. **The labor market is at historic levels of tightness; however, the pass-through to wage growth has been more modest than in the UK, where unemployment rates are significantly lower (3.7% as of December 2022).**[10] Growth in Eurozone posted wages accelerated in 2022, reaching 5.2% year-on-year in October, while growth in the UK was 6.2%.[11] UK wage growth has generally been higher than in the Eurozone due to both higher inflation and a decline in labor supply. The UK has experienced large flows from employment into economic inactivity, with almost 600,000 more people currently reporting as inactive compared to before the COVID pandemic. This has been due to sickness, low net inward migration during the pandemic, and more people taking early retirement.[12]

**It is our view that the broader economic outlook of slowing demand will adversely impact employment into 2023 and thus curb tightness in the labor market.** Eurozone unemployment is expected to increase to 7.2% in late 2023, only 60 basis points higher than its current level and substantially lower than in previous recessions due to more widespread labor shortages (**Exhibit 6**). UK unemployment is expected to peak at 4.7% in 2023, compared to a post-GFC peak of 8.1%.[13] This should ensure that a decent amount of slack emerges in the labor market and eases some of the current recruitment difficulties and slows wage growth.

If these assumptions are correct, this will have important implications for monetary policy. The dominant narrative has been that a very tight labor market gives workers a strong position to bargain for higher wages in response to high inflation. The recent wave of strike action across the UK from a wide range of public-facing professions could, for example, see wages pushed higher if the demands of labor are met. Stronger wage growth would then risk a wage-price spiral developing. However, so far the chances of that narrative playing out against a backdrop of recession look low. **We, therefore, expect monetary policy to begin to pivot away from an almost complete focus on minimizing the risk of high inflation, to one more evenly balancing growth prospects and inflation.**

**EXHIBIT 6:** ANNUAL INTERNATIONAL LABOR ORGANIZATION UNEMPLOYMENT RATES




Source: Oxford Economics, January 2023

10. European Commission, December 2022 & Office for National Statistics. Labor Market Data. January 2023
11. Central Bank of Ireland. Wage Growth in Europe: Evidence from Job Ads. November 2022
12. Oxford Economics. Labor market remains tight, but pressures begin to ease. November 8, 2022
13. Oxford Economics. Forecast as of January 24, 2023

# TRENDS AND OPPORTUNITIES

As we emerge further into this post-pandemic era, we would be remiss to not focus on the top-down trends driving the economic and capital markets of today. In particular, we believe deglobalization has become a powerful force as a consequence of COVID-19 and the war in Ukraine and has stark implications at both a secular and granular level. We will also provide a brief evaluation of CRE market fundamentals before sharing our views on the outlook for CRE.

## An Unraveling of Globalization

The COVID-19 pandemic had many far-reaching effects, but one of the most profound was the force by which the world so quickly pivoted to a path of "deglobalization." To be fair, deglobalization had already seen a series of shocks before the pandemic – the GFC, Brexit, the U.S.-China trade war, amongst others. However, the COVID crisis exposed risks and deficiencies in global supply chains that contributed to the inflation described above. The pandemic and more recent geopolitical unrest in Ukraine might not have caused "deglobalization," but they certainly accelerated it, and this emerging trend will have a long term impact on global economics, asset prices, inflation, and geopolitics.

Generally speaking, the world has gone through three main periods of globalization. The first occurred from 1870 to 1914, when a combination of tariff reduction and emerging technologies led to a dramatic increase in global trade. The second period began in 1945 following the Bretton Wood Agreement under which the U.S. agreed to integrate European economies and guaranteed secure global shipping to support worldwide trade. The most recent wave of globalization began after the fall of the Berlin Wall in 1989 through the ascent of China to the WTO in 2001, leading to a 50% increase in global goods exports during that time. Further, from 1990 to 2018, cross-border financial asset flows grew by 500%, and foreign direct investment flows grew by 700%, indicating not just a globalization of trade but also a globalization of financial markets. Looking at global trade as a percentage of GDP suggests that deglobalization could have started as early as 2011 or 2012, with trade volume never returning to its growth trajectory prior to the GFC in 2009.[14]

**We believe parts of Europe stand to benefit from enhanced deglobalization in the intermediate term and offers attractive risk-adjusted investment opportunities through the development of high-quality warehouse and logistics properties as multi-national companies look to nearshore production and supply chains and safeguard inventory.** Global supply chain pressures are easing but remain at elevated levels (**Exhibit 7**). According to a recent survey conducted by BCI Global, as much as 60% of European companies are planning to bring some of their production from Asia back to their own region. Central and Eastern Europe are favored (particularly the Czech Republic, Poland, Slovakia, and Hungary) as new locations for production in Europe, but about 50% of the companies surveyed will consider Germany, the Netherlands, and Belgium as well.[15] Together with a growing trend to reshore to the EMEA region, 'just in case' inventory management means that warehouse requirements will increase closer to end customers as well as to new production and supplier locations. **We believe this will create logistics requirements and drive the need for land that is well-located in areas with solid access to labor and major distribution corridors.**

**EXHIBIT 7:** GLOBAL SUPPLY CHAIN PRESSURE INDEX


Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index, January 2023

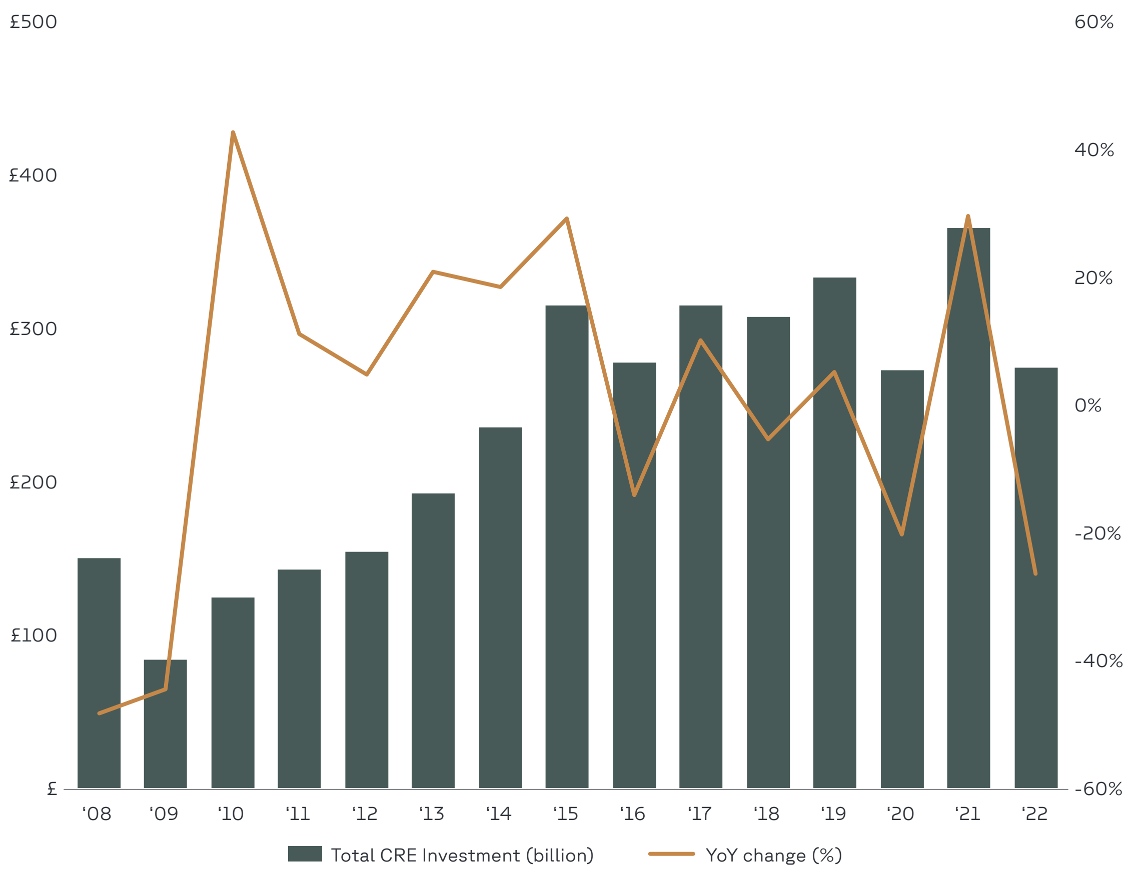
14. World Bank
15. BCI Global. Reshoring Production Back to Europe and the US is on the rise, particularly for critical parts and final production processes. February 17, 2022

## EVALUATING MARKET CONDITIONS

The economic backdrop presents both challenges and opportunities for CRE. **Market fundamentals in Europe are solid, with robust leasing activity, low levels of availability, and strong rent growth. However, credit markets are under increasing pressure as central banks continue to raise interest rates and borrowing costs remain high.** Investment activity has slowed markedly and transaction volume for 2022 was down 25% in comparison with the previous year (**Exhibit 8**).[16]

The performance of other asset classes is also affecting allocations to real estate. **Broadly, many institutional investors are dealing with portfolio challenges stemming from the "denominator effect" of real estate investments being overweight relative to publicly traded assets, such as equities and fixed income, given the latter's declines.** Some investors are attempting to rebalance their portfolios to reduce what is now an overweight to real estate. The correction in real estate values that is currently underway may also help to rebalance investor portfolios, albeit real estate value corrections almost always lag the broader financial markets due to a lack of liquidity.

**EXHIBIT 8:** TOTAL EUROPEAN CRE INVESTMENT




Source: Real Capital Analytics, Q4 2022.

Weaker growth, high inflation, and rising interest rates are likely to challenge capital markets with higher debt costs suggesting a price correction is needed. Our experience suggests that pricing is often moving faster than the data suggests, but with fewer investment comparables, valuers have been slow to adjust values. Prime all-property yields across the EMEA region fell to a near-record low in Q4 2021, averaging 4.31% and broadly in line with pre-pandemic levels. Since then, all-property prime yields have increased by around 80 basis points based on Q4 2022 data from CBRE.[16]

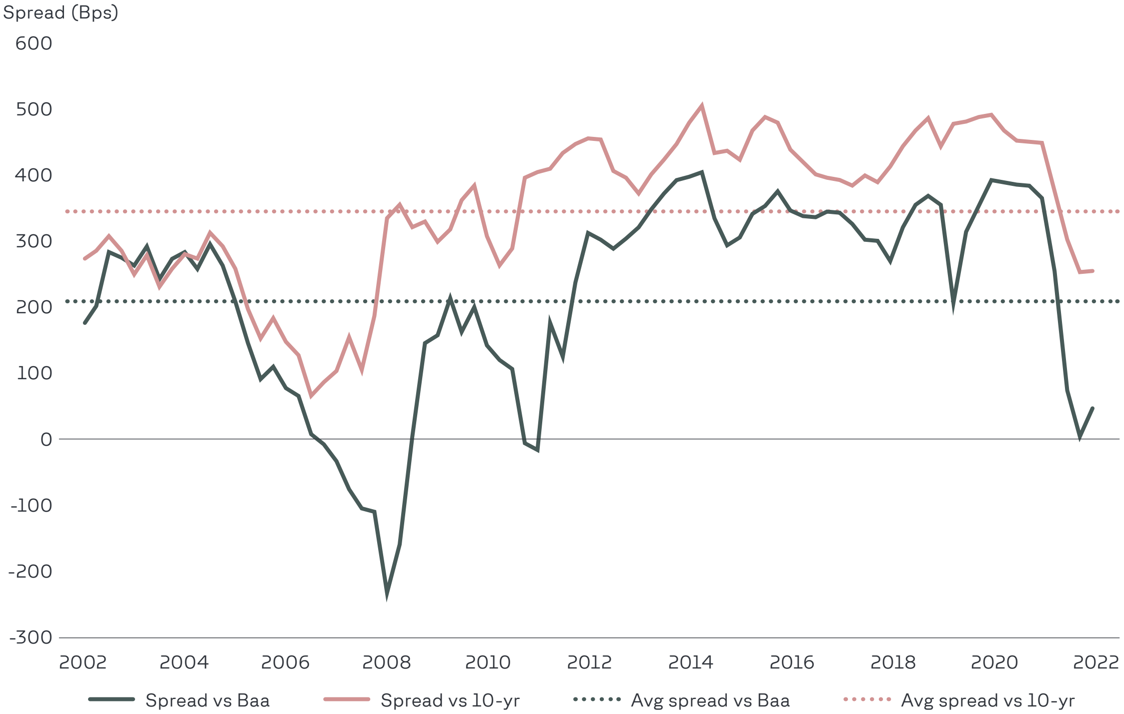


16. CBRE. EMEA Prime Yield Index. Q4 2022.

**While difficult to know exactly how much values have fallen, yields are rising across the board, impacting valuations and returns for investors. We do not expect that real estate yields will rise to the same extent as government bond yields.** Nevertheless, the spread over bond yields going forward is likely to be tighter than in the last decade (**Exhibit 9**).

MSCI data shows European commercial real estate's quarterly returns sank to -2.2% at the end of September 2022, down from 2.5% in June. Capital values across Europe have been impacted by rising yields, which had previously sunk to record lows in response to exceptionally low interest rates. Climbing yields were the major drag on the index, and the impact on capital growth was a quarterly contraction of 3.1% at the end of September 2022. Overall, income returns remained positive with growth of 0.9% in September 2022, demonstrating the attractive and stable income component of European real estate.[17] The potential for market-to-market rental growth, and inherent rent growth from inflation-indexed leases means that even if yields remain relatively flat, we could still see strong net operating income growth for well-performing sectors. **The market is adjusting quickly to the prevailing conditions; however, we continue to watch for more clarity on where yields and valuations sit.**

**EXHIBIT 9:** CRE YIELD SPREADS




Source: CBRE, Bloomberg, Q4 2022.

Note: Spreads calculated using CBRE EMEA Combined CRE Prime Yield, 10-yr euro bond & Barclays Corporate Baa Europe as of Q4 2022. Shows average spreads from Q1 2002-Q3 2022.

17. MSCI. Europe Quarterly Property Index. September 2022.

## COMMERCIAL REAL ESTATE OUTLOOK

**Overall, the stability of real estate capital markets has deteriorated compared to six months ago; however, in our opinion, the long term demand drivers for European real estate remain attractive, and barring a significant recession, the outlook remains healthy.** Positive fundamentals in the occupier market meant Eurozone rents rose across all segments by 6.0% year-over-year in Q4 2022 and logistics rents rose by 9.0% year-over-year.[18] **Such fundamentals are one reason why acquisitions of European logistics real estate in 2022 was still 18% higher than the average for 2017-2021, albeit the bulk of activity occurred in Q1 2022.**[19] Over the next year, income returns, rather than capital growth, is likely to be the driver of CRE returns. This means more focus on asset management, and on the financial performance of tenants, as key factors that affect income and occupancy at the asset level.

Recent shifts in the economy may also have negative consequences across parts of the residential housing market. As outlined in our recent update on the UK residential market, we expect house prices to fall over the next 12 months as rapidly rising debt costs have caused significant movements within the household mortgage market. For UK borrowers in particular, the challenges presented in the current market may become evident sooner, where the majority of mortgages are based on fixed rates of one to five years.[20] **Data from the BoE and UK Finance suggests that around half of UK household mortgage contracts are due to expire by the end of 2023.**[21] **To the extent that rates stay elevated, this means that as many as half of mortgage holders will see an impact in the next 12 months.** Overall, we expect less distress in the UK housing market as compared with previous market downturns; however, things could change in the event of a severe recession which has a significant impact on job security. The knock-on effect of a slowing of house sales has been a surge in demand in the build-to-rent (BtR) market, comparable to the multifamily market in the United States. We see an opportunity to capitalize on unmet demand for institutionally owned multifamily housing in the UK and will outline our strategy in the forthcoming sections.

We expect CRE prices to correct further, as yields expand after over a decade of exceptionally loose European monetary policy. **While we are finally seeing yields increase on a valuation basis, robust and resilient rental growth in sectors like multifamily and logistics – now very meaningful portions of the overall property universe (41% combined) – should cushion the declines at the all-property level.**[22] Capital Economics predicts the peak-to-trough fall in Eurozone all-property capital values will be limited to around 15%, with the decline largest for offices, and stronger rental growth supporting logistics, and a smaller rise in yields to retail. Further ahead, structural shifts favor the logistics sector which is expected to outperform relative to other sectors.[23] In our view, the distress is unlikely to reach anything like the proportions of the GFC, during which capital value declines were more dramatic when, in only two years (2008-09), there was a cumulative loss of 24%.[24] Real estate companies are not as leveraged as they were going into the GFC largely due to the regulatory changes of the past decade and a half. Though the availability of capital has declined, we do not expect liquidity to fade altogether as it arguably did during 2008-09.



18. CBRE. Eurozone Prime Rent Index. Q4 2022
19. Real Capital Analytics. Capital Trends Europe. Q4 2022
20. European Mortgage Federation, Hypostat 2022
21. Macro Strategy Partnership. Endgame: What will cause the Fed to turn? October 5, 2022
22. Real Capital Analytics. Capital Trends Europe. Q4 2022
23. Capital Economics. Eurozone Commercial Property Outlook. December 9, 2022
24. MSCI, Europe Quarterly Property Index (Unfrozen). Accessed December 9, 2022

Distressed sales have remained scarce, and the jury is still out on how much distress will emerge from the prevailing conditions. The deep discounts to net asset value in the listed sector during 2022 indicate a correction is due. As of January 31, 2023, the FTSE/EPRA Nareit Developed Europe Index has fallen 32% compared with January 2022 levels (**Exhibit 10**).[25] A decline in the amount of leverage that lenders will provide, combined with falling capital values, could also trigger refinancing problems for maturing real estate loans. While capital remains available for deployment, there has been a decline in loan-to-value (LTV) ratios in some markets. As of Q4 2022, LTVs are typically in the range of 50-55% for loans against prime offices, retail, and logistics sectors.[26] We may also see some distress to the extent that investors become overallocated to real estate and therefore need to sell. **While we do not foresee an influx of distressed assets onto the market, we anticipate the current market dislocation may open up opportunities for those who have access to capital.**

**EXHIBIT 10:** FTSE EPRA NAREIT DEVELOPED INDEX


Source: Bloomberg, January 2023

New development is expected to slow due to higher borrowing costs and economic uncertainty. Although construction cost inflation appears to be easing, we do expect supply conditions to remain tight in the short term. This lack of new development is seen by some as a positive for existing assets and their owners. Supply and demand imbalances facing a number of markets across Europe mean that logistics and multifamily sectors stand out with their positive rental growth prospects.[27] The ability to regularly rebase rents to capture growth in many markets means multifamily is well placed to weather current high inflation, although this is arguably stretching affordability in some markets.

25. Bloomberg, Accessed January 10, 2023
26. CBRE. European Debt Financing Review. Q4 2022
27. Capital Economics, Eurozone Commercial Property Outlook. December 9, 2022. Savills. UK & European Multifamily 2022: The Inflation Hedge? September 7, 2022

## Commercial Real Estate Opportunities

Affinius Capital continues to pursue several core investment themes, which we believe present attractive opportunities both in the near term and over the long run. We discuss all our investment strategies later in this report; however, the following represents three major themes that will underpin Affinius Capital's investment platform as this new economic and real estate cycle takes hold:

### I. THE INTERSECTION OF TECHNOLOGY AND REAL ESTATE:

Our focus here will be on those critical elements of real estate infrastructure that serve as essential building blocks for the new economy while also satisfying investors' growing need for reliable and sustainable income, including:

**Logistics:** Our primary investment focus in Europe has historically been logistics, which has been a fortunate sector to be in over the last eight years, given the strong demand. Despite economic headwinds, persisting supply-demand imbalances have contributed to strong rental growth. The shift in financing conditions over recent months has led to increasing investor caution putting upward pressure on yields. However, **of the traditional real estate sectors, logistics looks most attractive on a risk-adjusted basis, given positive structural tailwinds. New sources of occupier demand are being driven by i) the reorganization of supply chains, ii) increased local inventory levels to assure resilience, iii) obsolescence of existing stock and increasing need for modern automated facilities with sustainable specifications, iv) advocacy of new sourcing practices v) more widespread adoption of technology and vi) e-commerce growth.**

Take-up across Europe totaled over 30 million square meters in 2022, reflecting an increase of 33% compared to five-year average levels.[28] We believe take-up is poised for another strong year in 2023, with volumes expected to remain above average, albeit below recent record-breaking periods partially due to lack of available space given low vacancy levels and limited new inventory being delivered to the market. Demand is being driven by an increasingly diverse range of companies with third-party logistics providers leading the way at a sector level, a trend observed across the UK and Continental Europe. We anticipate this trend to continue as organizations seek greater flexibility in their supply chain processes.

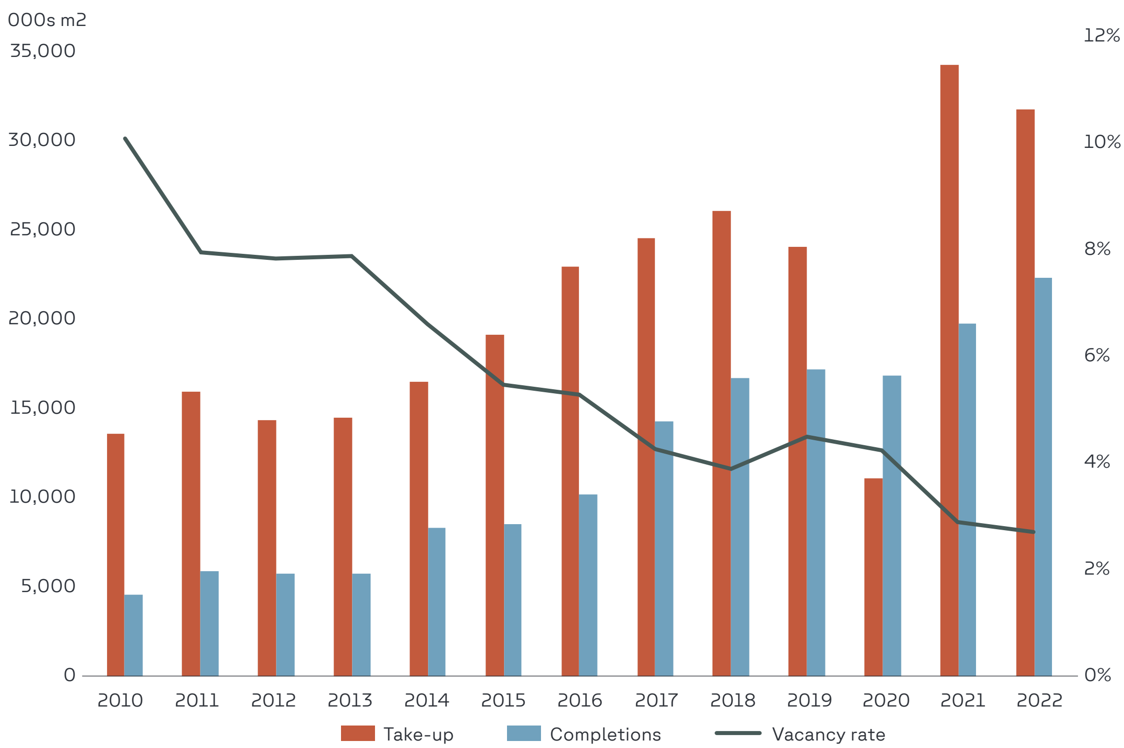


28. CBRE. Q4 2022

The average vacancy rate in the top nine countries continued to decrease to around 2.7%, which is now limiting take-up in some markets. Despite an 8% year-over-year increase in total stock in 2022, this was insufficient to improve availability (**Exhibit 11**).[29] Construction material prices remain elevated but are starting to stabilize from recent highs. However, labor shortages will continue to impact construction timelines which could lead to project delays and elevated pricing. We anticipate vacancy rates will remain low given the combination of strong demand and constraints on development including the availability of consented land, elevated financing costs, and constrained availability of construction labor.

**We believe market rents will continue to increase to align with the increased cost of development and resulting from strong demand and scarcity of available modern space.** European logistics investment decreased 23% year-over-year during 2022 to reach a total of €58.8 billion, an impressive performance given the uncertain backdrop. Activity was boosted by Blackstone's recapitalization of its Mileway portfolio for €21 billion, demonstrating that large deals are still prevalent, although admittedly this deal happened prior to the current market correction that is underway. Prologis also closed on the €1.6 billion Crossbay portfolio in September 2022. While such a sizeable deal is a boost for the market, the transaction was at a notable discount of around 20% to initial ambitions when the portfolio was launched in February 2022.[30] While the sector's resilience continues to attract active investment interest, some investors are showing signs of caution amid tight financial conditions and current market repricing. This uncertainty is evident in the slowdown in transaction volume in the second half of the year. Nevertheless, one of the clearest themes that have emerged, is the incorporation of logistics as a mainstay of the institutional investor portfolio. This is having a marked impact on the structure of CRE markets. Logistics accounts for 20% of all European acquisitions, double the average since 2007. Offices remain the largest sector, but its share of total investment has fallen from 46% in 2007 to 33% in 2022. We believe the current capital reallocation to the logistics sector is set to last and will be supportive of the market in the medium and longer term.[31]

**EXHIBIT 11:** EUROPEAN LOGISTICS TAKE-UP, COMPLETIONS AND VACANCY




Source: CBRE, Q4 2022

29. Ibid
30. Real Capital Analytics. Capital Trends Europe. Q4 2022
31. Real Capital Analytics. Capital Trends Europe. Q4 2022

**Data Centers:** Driven by the ever-growing need for data storage, computing, and networking, data centers are large beneficiaries of the expansion in technology. In the next three years, the total amount of data in the world – the global datasphere – is predicted to increase by 300%.[32] **We think there will be opportunities to capitalize on the exponential growth in demand for data center capacity in Europe and believe it pairs well with our existing logistics business.**

The market is dominated by trading and administrative centers such as Frankfurt, London, Amsterdam, Paris, and Dublin, the so-called FLAP-D markets. These gateway cities are strategically located with proximity to a substantial base of end users and current readiness of fiber accessibility to global networks. Aggregate demand in these markets is estimated to have reached a record 380 megawatts (MW) in 2022, which was broadly in line with the 389 MW recorded in 2021. CBRE anticipate even stronger demand (440 MW) for data center capacity in Europe during 2023.[33]

Currently, hyperscale data centers are in demand from cloud operators seeking large facilities within metropolitan regions. Smaller cloud platform providers are also seeing growing enterprise demand and are increasing the size of their availability zones. They are also seeking more pre-lets in markets that are supply constrained. Despite a strong supply pipeline, there are still barriers to entry, including significant power and fiber requirements, restrictive planning, availability of consented land, and the need for these facilities to be near end-users.

A combination of growth opportunities, customer demand, and the need for lower-latency for delivery of services, have led to a significant increase in interest for emerging market facilities – from investors, providers, and international customers. Growth in secondary markets has been one of the hallmarks of the past year, with increasing interest in markets such as Madrid and Milan, among others.

**Digital Media Platform:** In conjunction with our affiliate Square Mile Capital, we will continue to capitalize on the intersection of media and technology coupled with the rapid increase in demand for digital content. **Statista forecasts that global video streaming revenue will increase 72% over the next several years – rising from $80.8 billion in 2022 to $139.2 billion by 2027.**[34] Similarly, the segment will experience strong consumer adoption growth, expanding from 15.2% of consumers in 2022 to 20.6% by 2027. Thus, robust digital content demand will lead to remarkable growth in studio and creative office space. We are responding to strong demand in the U.S., United Kingdom, Canada, and Europe.



32. Aston University. Too much information - Aston University researchers to tackle global data storage crisis. Published December 19, 2022
33. CBRE. Europe Data Centers Figures. Q3 2022
34. Statista. Worldwide Video Streaming (SVoD). November 2022

Around a third of European households live in private rental homes, up from 26% over the last decade.[36]

## II. RENTAL HOUSING:

Investment in Europe's residential sector decreased 14% in 2022 versus the five-year average; however, the downturn is exaggerated by the completion of some exceptionally large deals, including the Vonovia-Deutsche Wohnen deal in 2021.[35] The European market is rapidly maturing and continued densification in and around major cities sets the stage for long term growth. Living in rental homes isn't a new concept in Europe; however, the way these homes have been provided is changing. Rental homes have historically been provided by the state, landlords owning one or a few units, and privately-owned real estate companies. Now they are increasingly being joined by large-scale private and institutional investors who are looking to capitalize on strong social and demographic tailwinds by building purpose-built housing for rent in scale.

**Multifamily:** We see an opportunity to take advantage of unmet consumer and investor demand for institutionally owned multifamily housing in the UK and select European markets through developing multifamily rental homes in locations with compelling market dynamics. **Around a third of European households live in private rental homes, up from 26% over the last decade.**[36] This reflects a range of social and demographic trends. For example, population has been increasing, particularly in the younger, typically renter cohorts. Affordability has also been a factor contributing to the rise in the proportion of people who rent rather than own their homes.

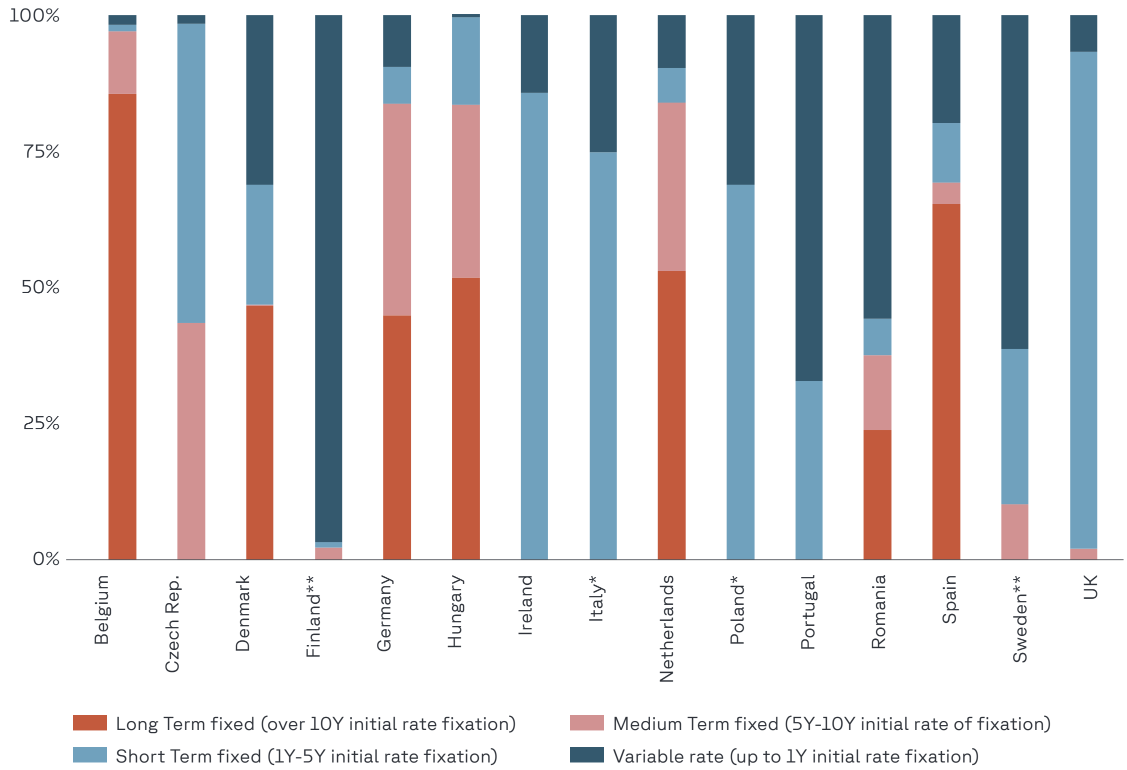
The markets across Europe are all at various stages of evolution of their respective multifamily rental markets, with some further progressed. Germany is one of the most mature markets and has by far the highest level of multifamily investment. Whereas in the UK, existing product is fragmented, generally undermanaged, and poorly invested by the traditional private ("mom-and-pop") owner as compared to the multifamily market owned by institutional investors. This provides an opportunity to introduce higher standards of design, service, and asset management with rental housing increasingly being embraced by the consumer. **The UK population is forecast to add a further 1.7 million people to the population over the next ten years, exceeding 69 million by 2031.**[37] **As a result, we anticipate growing demand for modern, purpose-built rental accommodation.**

35. Real Capital Analytics. Capital Trends Europe. Q4 2022
36. CBRE. Multifamily Housing in Europe. April 2021
37. Ibid

As outlined in our recent paper on the UK Residential Market, we expect the current rise in interest rates to exacerbate affordability constraints and cause many households to remain or become renters. Markets dominated by household mortgage loans with long fixed rate periods like Belgium, Germany, Spain, and the Netherlands will see the biggest impact on first time buyers, as existing owners with a mortgage will only be impacted if they need to refinance. At the opposite side of the spectrum, in markets like Poland or the UK, where short term and adjustable-rate mortgages dominate, existing owners will also be impacted by rising rates. In the latter markets, a decline in house prices is, therefore, more likely, while in the first group of countries, price effects are expected to be more limited. Rental housing's relative attractiveness compared to ownership at the current juncture is expected to support demand. We anticipate demand for newer multifamily product to increase, as consumers realize the benefits of purpose-built apartments. Current estimates are that around 35% of residential stock in Europe is over 50 years old, with three-quarters being energy inefficient. Rising energy bills may add to the attractiveness of new multifamily product which are more energy efficient.[38]

As the stock of quality renting options available in the multifamily sector expands, we expect many more households will become renters by choice.

**EXHIBIT 12:** MORTGAGE MARKETS BREAKDOWN BY INTEREST RATE TYPE (%) – NEW LOANS Q2 2022




Source: European Mortgage Federation, 2022

Note: *Mortgages with a fixed rate over 1 year are combined.
**Mortgages with fixed rate over 5 years are combined



38. Savills. UK & European Multifamily 2022: The Inflation Hedge? September 7, 2022

**III. DEBT CAPITAL:**ending for real estate in Europe has typically been the domain of banks, life insurance companies, and some pensions. However, many of these traditional CRE debt capital sources remain constrained by the current regulatory environment. **Regulations imposed by Basel III have created a more risk-averse lending environment at the balance sheet level and within the securitization markets.** With banks and other traditional lenders struggling to navigate the strict regulatory environment, a gap remains between borrower needs and credit availability. Consequently, there remains an opportunity for alternative lenders to fill this void, create velocity, and capitalize on the robust demand in the commercial lending sector.

**At this point in the cycle, we believe complementary debt and preferred equity strategies offer highly attractive, risk-adjusted returns consistent with our defensive posture while also providing downside protection.** The rapid rise in interest rates across Europe and correction in market values are expected to constrain traditional lending as lenders seek to maintain debt service coverage ratios (DSCR) which is expected to reduce LTV ratios down. A decline in the amount of leverage that lenders will provide, combined with falling values and higher interest rates could result in difficulties in refinancing maturing loans. According to one estimate, the debt funding gap in the UK alone is estimated at £27 billion.[39] We anticipate opportunities will arise for alternative lenders to originate new lending as well as refinance existing loans across a spectrum of financing situations.



39. RE Capital. Inside real estate's refinancing conundrum

# EUROPEAN INVESTMENT THEMES AND STRATEGIES

As we advance into our ninth year of investment in Europe, Affinius Capital has successfully executed and exited multiple investments across the region. We remain cautiously optimistic about the depth and duration of the current economic slowdown and the nature and extent of economic recovery. We plan to continue and, in some cases, accelerate our European investment activities, focusing on markets and product types with strong and durable economic and cultural drivers, favorable demographics, and healthy real estate fundamentals.

Since 2014, Affinius Capital has invested in European logistics, mainly through development, creating an enviable and proven track record in delivering successful and complex logistics development projects throughout the UK and Europe. We have become a market-leading, pan-European, logistics development, and investment platform specializing in the development of large footprint modern logistics assets. Our extensive, strategically located network of logistics projects currently spans seven countries, providing access across Europe's major supply-chain corridors. We believe that we are positioned to take advantage of the further maturation of the logistics real estate market in Europe as well as the current capital markets dislocation, and we see the opportunity to grow our investment activities in this area further including our geographic reach in Europe.

Our European development activity has largely capitalized on surging demand for new big-box logistics warehouses. We have also realized opportunity in the growing demand for consumer-centric, mid-sized regional warehouses in campus formats proximate to large population centers. **In response to demographic trends of urbanization, growing e-commerce and consumer demand, we have seen the greatest opportunity in the development of logistics campuses near large population clusters that can accommodate occupier demand in a range of sizes and allow for active asset management, and tenant diversification.**

The need for warehouses close to population centers is especially prevalent in Europe, where three-quarters of the population live in cities. Despite this, Europe has only one-third as much warehouse space per capita as the U.S. On the other hand, the scarcity of locations with planning approval and growing demand for distribution and logistics space has resulted in premium values for well-located development-ready land and has created opportunity to create significant gains from taking land successfully through the planning process, especially those locations with significant power and labor availability. In the current uncertain market, we will remain defensive in this area while still recognizing the strategic advantage that a well-located and attractively priced land bank provides. In locations with sustainable growth prospects and barriers to entry, we will look to hold modern logistics assets and benefit from the modernization and sector change in the logistics market.

There is a compelling opportunity to invest in areas where technology and real estate are converging, and we can capture demand as digital transformation continues to accelerate. At the intersection of this is investing in Europe's data center infrastructure. From an investment perspective, the site selection process and some construction elements mirror modern logistics warehouses. Therefore, we will be leveraging our logistics expertise in pursuit of data center opportunities as they emerge.

**We also see a growing opportunity to develop institutional-quality multifamily residences in select European markets based on compelling demographics and supply/demand factors, in particular in the UK. Institutional ownership of purpose-built for-rent residential has become more mainstream in Europe, but there are still opportunities to develop a high-quality modern product.** The residential sector in Europe is highly fragmented and facing increasing regulatory pressures with government rent control measures, creating an inefficient market. We have recently created a joint venture to develop a BtR multifamily portfolio across leading UK towns and cities. We see a compelling opportunity for us to leverage our multifamily expertise in the UK, as well as in other European markets.

Similar to our track record of uncovering value investing themes in the U.S., we will look to capitalize on opportunities driven by demographic shifts, the inadequacy of capital at specific points along the risk spectrum, and individual property types or markets that appear to be mispriced compared to the actual underlying risk profile. We continue to manage a suite of complementary debt and preferred equity strategies, which offer an interesting way for investors to access the market, specifically in the U.S. At this point in the cycle, these strategies are attractive for investors that are focusing on yield as a risk-adjusted investment play. Beyond the U.S., Europe represents significant potential for expansion of our debt platform with similar market dynamics.

**We believe alternative lenders are well-positioned to take advantage of CRE lending opportunities arising from dislocations in the capital markets going forward. Bank regulatory changes, including implementation of Basel III have reduced appetite among traditional lenders for balance sheet lending, especially for value-add and development.** Non-bank lending share is now clearly established, and this combined with increasing broker intermediation should make it easier for high-performing lenders to break through a historically direct relationship-driven market. We expect the development of credit products in Europe will stand as a strong complement to our existing European equity strategies and vice versa.

As in the U.S., we will take both a strategic and tactical approach to value-driven investments and in the current market environment patience and looking at relative value and discount to the re-set replacement cost will be ever more important. We expect Europe's economy to remain supportive of real estate markets in the long term. Consequently, we believe there will be opportunities to acquire existing assets, provide development and transitional capital, and even consider structured debt or equity investments across some markets and sectors. Over the long term, we will continue to grow our investment platform in Europe, and adjust to market opportunities, while maintaining a cautiously optimistic and patient outlook.

# CONCLUSION

Given the volatile economic, capital markets, and geopolitical environment, we recognize today's market is fraught with risk. Our investment platform was designed to capitalize on market disruptions, which ultimately leads to value-creation opportunities and the ability to acquire assets below replacement cost. While some investors have chased yields in recent years, our value-investing approach to real estate is consistent across market cycles.

**This methodology requires being quick to respond to emerging opportunities, while also:**

1. ADHERING TO OUR GUIDING INVESTMENT PRINCIPLES
2. MAINTAINING A DISCIPLINED UNDERWRITING APPROACH
3. REMAINING PRUDENT IN THE FACE OF WIDESPREAD UNCERTAINTY

Thus, against a quickly evolving economic backdrop, Affinius Capital will continue to emphasize capital preservation while actively and aggressively seizing opportunities that reflect our primary investment themes. As the direction of markets remains uncertain, value creation and fundamental real estate investment skills regain importance. Development and value-add strategies will still benefit from a compelling spread between cost and value, even if values flatten or decline in 2023.

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