UBS Asset Management

Investing in real estate – Adapting to economic trends

Real estate is the backbone of the economy, whether on a global or local scale. The economy relies on specific types, quantities and qualities of real estate to facilitate the production of goods and services we use daily. As the economy changes, so too must the real estate assets that support it.

Real estate investors must accommodate this need with the type, quality and location of said real estate in mind. Focusing on investing in specific real estate sectors reflects an understanding of economic trends and how these investments address the evolving demand for shelter, driven by economic change.

Let's take an example. In 2012, online retail sales in Europe accounted for approximately 5 percent of total retail sales. A decade later, this share exceeded 15 percent.[1] Between 2015 and 2022, ecommerce sales in key Western European markets more than doubled, showing real growth of approximately 8 percent per year.[2] Real economic growth in Europe was 1.6 percent per year during the same period, for comparison.[3]

At the start of this growth, Europe lacked the necessary logistics facilities to accommodate this ecommerce growth. Buildings were needed – and built they were! According to CBRE, the investible logistics stock in nine major European markets (Belgium, Czechia, France, Germany, Italy, Netherlands, Poland, Spain, United Kingdom) grew from less than 200 million square metres in 2012 to more than 380 million square metres today. Despite an average annual accumulated stock expansion of more than 6 percent in those countries, rents have increased by more than 100 percent in some markets since 2012.

This rapid expansion of Europe's logistics sector was a direct response to the changing economy. The real estate industry adapted logically: building high-quality warehouses in the right locations to meet the demands of ecommerce growth.

Where is the European economy going?

Back in November 2024, UBS published its 2025 outlook: "UBS Year Ahead 2025: Roaring 20s – The next stage", highlighting the importance of the five Ds: debt, deglobalisation, demographics, decarbonisation and digitalisation. Those five Ds remain key factors likely to drive markets and economies in the years to come, presenting both opportunities and risks for investors. Let's delve deeper into the importance of each of those Ds.

Debt

Many European governments are burdened with debt. European governments are likelier than not to curtail their spending, thereby reducing the aggregate demand in the economy, to avoid moving even further away from their deficit and debt targets. This reigning in of spending reduces inflation pressures in the economy, consequently leading to lower interest rates as central banks respond by lowering their policy rates to keep economic activity at an acceptable pace. Lower interest rates can lead to higher asset prices, including real estate, as discount rates are adjusted downwards.

Deglobalisation

Geopolitical tensions have re-emerged, putting regionalisation of supply chains and reduced reliance on adversarial economies at the forefront of investors' minds. Europe's increased defence spending and efforts to secure critical resources, such as energy, chips or pharmaceuticals, will necessitate an economic reorganisation, which is likely to influence real estate demand.

Demographics

The European Union's population, standing at 448.8 million in 2023, is expected to peak in 2025 before gradually dropping back to 447.9 million by 2050, and 419.5 million by 2100. The number of people aged 80 and older, however, is expected to increase from 27.1 million (2022 number) to 64 million by 2100.[4] That is an annual growth rate of more than 1 percent per year. This may not sound like much, but such growth is seldomly seen: less than 5 percent of EU cities and detailed administrative areas – here defined as the NUTS 3 regions – have seen a population growth of that level or more for the last 20 years.[5]

Decarbonisation

Real estate is responsible for roughly one-third of Europe's energy-related greenhouse emissions.[6] In April last year, the European Union adopted a new Energy Performance of Buildings Directive, aiming to increase Europe's energy independence and reduce its consumption of fossil fuels – a motive partially driven by geopolitical factors.[7] Notably, for nonresidential buildings, EU member states are required to renovate "the 26 percent worst-performing [in terms of primary energy use] buildings by 2033" or within eight years.[8]

Digitalisation

Artificial intelligence is likely to prove to be one of the most influential technologies of the century. To enable it, however, we must provide energy and infrastructure to house the computers running it. AI and other data-generation activities (e.g. social media, streaming, internet-of-things, etc) are driving a growth rate of approximately 35 percent per year for data since 2010.[9] Continued digitalisation is expected to sustain this trend.

The sectors that are likely to benefit

With the five Ds in mind, we can identify which real estate sectors are likely to benefit the most from the changing economy. Remember: To invest in the most successful real estate sector, simply follow the direction of economic trends.

The life sciences real estate sector is a top contender and likely to benefit from many of the Ds. Deglobalisation and geopolitics shifts are driving companies to establish facilities in Europe to meet the demands of its nearly 450 million people market, particularly as globalised supply chains tighten. Demographics are also clearly increasingly funnelling spending power of societies towards medicines and other outputs of the sector, which require shelter to be developed, manufactured, stored, shipped and sold. Digitalisation is also likely to prove to be a net benefit for the sector as it lowers the entry barriers for new firms, along with reducing the cost of expensive research for established players.

The residential sector is another strong potential, with opportunities across retirement homes, student housing, serviced apartments, co-living and multifamily assets. These segments are reinforced by demographic shifts, offering long-term investment prospects. Solving the operational real estate challenges, however, and navigating strict building and zoning regulations will be crucial to unlocking these opportunities.

Data centres are the third clear winner, driven by digitalisation. The growth of this sector has already been eye-catching, with installed capacity in Europe growing from approximately 1,200 megawatts in 2017 to approximately 4,700 megawatts by the end of 2024, an annual growth of more than 20 percent.[10] This growth is expected to continue as AI and other data-intensive technologies expand. The primary challenge, for example, will be to find the available energy within the ageing European energy infrastructure and tight energy supply.

Finally, while not sector specific, energy efficiency–focused real estate investments are likely to benefit from the decarbonisation trend. Regulatory pressures and tenant demand for cost-effective, predictable operations are driving the push for more efficient buildings. This focus on energy efficiency will not go away; the changes in the economy — driven by geopolitics, as well as simple profit-loss calculations — are calling for them.

Don’t get lost in the details, follow and embrace the trends

It would be understandable if real estate investors, many of which are licking their wounds from the past two-and-a-half years of a challenging investment environment, would feel pressured to position themselves, given the coming changes in the economy. After all, it may seem easier to stick to familiar, well-established sectors rather than invest time and effort in understanding the drivers of emerging ones, especially when the benefits may appear uncertain.

As the saying goes, however, “perfect is the enemy of good”. It is better to position oneself to align with economic trends, even imperfectly, than to never dip into those waters. Ten to 15 years ago, many real estate investors hesitated too long to explore the logistics sector, which is now a staple in any well-diversified real estate investment portfolio.

Let us not repeat the mistakes of those who came before us.

Notes:

[1] The Centre for Retail Research, see Online Retail : UK, Europe & N. America : The Centre For Retail Research

[2] Ibid, plus data from Refinitiv

[3] World Bank

[4] Eurostat, Demography of Europe – 2024 Edition, and European Commission, Population projections in the EU, 2023

[5] Based on data from Oxford Economics. More than 1,200 NUTS 3 regions, many of which are cities, exist.

[6] European Environment Agency, Greenhouse gas emissions from energy use in buildings in Europe, European Environment Agency's home page

[7] The European Commission, Energy Performance of Buildings Directive adopted

[8] Ibid

[9] World Economic Forum, Growing data volumes drive need for ICT energy innovation

[10] Estimate based on data from CBRE

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* Assets under management stated on gross asset values basis, reflecting values as of 30 September 2024, where available.