

Turning Europe's real estate complexity into an investment opportunity



The volatility of the past few years has created a new investment dynamic and operating environment. With shorter real estate investment cycles and valuations in some markets seemingly bottoming out, well-positioned investors should benefit from a different, flexible approach as a means to find pockets of growth. Annette Kröger, CEO Europe, PIMCO Prime Real Estate, reflects on why the current investment window needs a change of mindset.

In PIMCO's most recent real estate market outlook, *Turning the Corner? Commercial Real Estate Themes for 2025*, we asked ourselves the question, is the downturn in commercial real estate coming to an end? The collective view of senior investors from PIMCO's commercial real estate platform was that the recovery will likely be slow and uneven, requiring a strategic focus on specific geographies, sectors, and assets.

The volatility of the past few years has created a new investment dynamic and operating environment, one with a much shorter real estate investment cycle. Markets are recovering at different speeds, resulting in a fragmented Europe: while the UK, Germany and France are facing structural challenges, Spain and Italy are benefitting from clearer growth dynamics.

In this environment, the investment case for active asset management – redeveloping, repurposing and upgrading buildings – has taken on far greater value, particularly given the attractive pricing being seen in parts of Europe's real estate sector. This means, at this point in the cycle, finding opportunities which feature strong Net Operating Income growth and creating value within individual assets.

A time to focus on high conviction themes
Even in instances where individual markets present difficulties, a nimble, diversified investment strategy can find investment opportunities where relative value is highest. A shorter investment cycle means investors need to be able to pivot across high conviction themes supported by key secular macro-trends such as, for us, demographics, digitalization and decarbonization.

Residential and logistics are two such high conviction themes for Core investors, we believe, with the most attractive long-term opportunities found in gateway cities

and infrastructure nodes: from student accommodation in the UK to micro living in Denmark; build-to-rent in Sweden to logistics in Italy, among others.

Data centers is another favored theme for Europe, with demand being driven by increased connectivity, cloud adoption and commercialization of AI. There is still a long runway for customer migration to the cloud, given 90% of global IT spend remains 'on premise' as of today, and the cloud business lines of hyperscalers are growing between 17-31% year on year.

Here, we are seeing particular demand in Tier 2 and 3 markets such as Madrid, Milan, Zurich and Berlin, which historically have less capacity compared to Tier 1 markets like Frankfurt, London, and Paris.

In the office sector, best-in-class assets – well-located buildings with low carbon footprints, appealing amenities, and high occupancy – will weather the storm. The opportunity lies in the development of 'brown-to-green' investments that target Class B+ and A properties in prime locations.

Sustainability, tenant-centricity, and technology: the new baseline for long-term liquidity

Managing and developing prime assets today is about delivering sustainability, tenant-centricity, and technology. These three areas have continued to rise up the value chain, playing a central role in value creation and resilience. Indeed, the data that asset managers can glean from technology – particularly when it comes to more sustainably-focused operational aspects of buildings – can be a game-changer for real estate.

PIMCO Prime, through its proprietary Building Signature Program, has executed a program of smart upgrades to assets, including sensors and devices which

collect granular building data via a smart dashboard. As of December 2024, the firm has upgraded EUR9 billion worth of assets and is considering an additional EUR7 billion in potential upgrades by 2027¹.

The importance of sustainability has not gone away in Europe, and, on a long-term basis, it's expected to drive competitive valuations and define market leadership. Logistics remains a prime example of a segment where liquidity and demand remain strong for assets which boast high certifications and, for example, well-defined photovoltaic and EV charging infrastructure.

In conclusion: strong prospects across markets but through pockets of growth

Generating superior returns, through a dedicated, bottom-up approach rather than primarily depending on decreasing cap rates, means taking advantage of today's compelling market opportunity and inherent pricing fundamentals. The importance of timing should not be underestimated in the current environment.

We see strong prospects across markets but through pockets of growth supported by macro trends and robust rent rises rather than relying on low rates.

In Europe, a region potentially facing lower and fragmented economic growth, investors will need to be very clear about which sectors and assets have stronger prospects of outperforming and look to capitalize on not just the market cycle but the asset life cycle as well. Identifying locations with robust economic prospects will be crucial for finding opportunities over the next 12 months, as will be selecting the right assets to drive investor returns.

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¹Source: PIMCO Prime Real Estate as of 31 December 2024.

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