Europe's emerging alternative sectors

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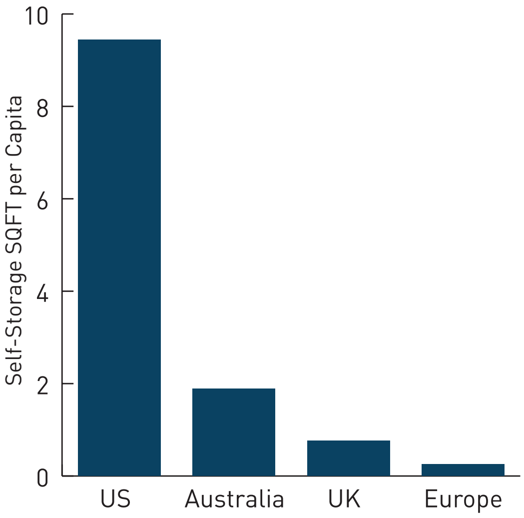
When Harrison Street entered Europe in 2015, alternative sectors like Purpose-Built Student Accommodation (PBSA) and Build-to-Rent (BTR) were considered niche real estate asset classes. Scalable, institutional-quality opportunities in these sectors were few and far between, but today the opposite is true. In the past decade, developers and investors have rotated away from commercial sectors towards more mature alternative sectors such as PBSA, BTR and Life Sciences, attracted by strong outperformance, lower volatility and less correlation with macroeconomic cycles, additive diversification, and attractive demographics that look set to underpin the future performance of these sectors.

Other emerging alternative sectors such as digital, healthcare and self-storage have also been underpinned by similarly strong fundamentals but have remained relatively underinvested in Europe to date. Harrison Street has invested in these sectors in the US since 2006, investing €18bn across 635 assets over that timeframe. We have also tracked these sectors in Europe for a number of years and have waited to time our entry point until the opportunity is most favourable. We believe that 2024 provides that opportunity as we move towards the next phase of alternative sector investment in Europe. While these sectors remain highly fragmented with high barriers to entry, many similarities exist between these sectors in Europe now and the opportunity in the US almost two decades ago. The growing maturity of this group of alternative sectors means they have now reached a critical scale, with a greater number of opportunities across the investment spectrum to invest in or develop institutional-quality real assets in a number of European markets.

We believe these sectors provide compelling investment propositions given the current demographic trends and supply/demand dynamics. While commercial sectors have seen lower transactional activity and lease-up activity, sectors such as data centers have bucked the wider market slowdown. Fundamentals in the sector continue to be anchored by strong tenant demand, with most data center developments already pre-leased before commencing construction. FLAP-D* take up in H2 2023 amounted to ~584MW, over double the average half-yearly take up rates that we have seen since 2019.[i] Absorption rates across FLAP-D markets have outpaced delivery in almost every quarter during the past three years, driving vacancy rates down to 2.8% as of the end of 2023.[ii] Demand dynamics into

European Self Storage is significantly less mature than the US – providing significant potential for growth



Source: FEDESSA

the medium-term seem set to remain attractive, with increased cloud adoption fueled by artificial intelligence and machine learning requirements driving future demand. The sector, however, remains constrained by significant supply barriers including the lack of available land. However, access to power remains the single biggest obstacle to growth. New developments in these markets are being told that power may not be attainable until 2026 or 2027. The lack of scalable power is likely to fuel the growth of emerging secondary markets where power constraints are less prevalent. These include major markets in Spain, Italy, the Nordics and secondary markets in prime countries, such as Berlin.

Healthcare real estate appears to be uniquely placed from a fundamentals perspective. Europe, like many regions around the world, has a rapidly growing aged population. While Europe's 75+ population is already larger than that of the US, what is most striking is the significant surge in 75+ population that seems set to fuel demand for senior housing and healthcare services. In the European Union, this age cohort is expected to grow by 64% by 2050, versus a 1% decline for the population as a whole.[iii] Based on those demographic trends, it is anticipated that countries like the UK require an additional 530,000 care home beds by 2050, to keep penetration rates in line with today's levels. [iv] This represents a 110% increase on total stock levels today and is indicative of the supply growth needed across all of Europe. The strong demand for senior housing is already reflected in rising occupancy rates for senior housing operators. Despite the disruption that arose from the pandemic, occupancy in the sector has rebounded strongly in Europe in the past year, now above pre-covid levels at 93% as of the end of 2023.[v] The difficult capital markets environment of the past 18 months has seen many investors slow or pause development activity, with typical forward funding transaction structures becoming less prevalent. This can provide an attractive entry point for longer-term investors with a track record in the sector, like Harrison Street, to establish programmatic joint ventures to bring much needed supply to the market as levels of new supply continue to fall.

While most commercial real estate sectors saw a market decline in investment during 2023, self-storage volumes totaled €860m in 2023 – up 35% on the €640m invested in 2022. European transaction volumes have grown at a 24% CAGR since 2018 as a wider range of investors have become active in the sector.[vi] Investment in the sector supported the growth of the asset class across Europe, with Europe's self-storage market now estimated to total 13.9 million sqm of gross area, across almost 7,000 stores.[vii] In the UK, industry reports imply that the size of the market has now reached critical scale, increasing by 32% to 5.2 million sqm in the last 5 years.[viii] Harrison Street believes that investors have been drawn to the self-storage sector due to its strong operational performance, robust returns and defensive characteristics that are not closely linked to economic cycles. Shorter lease lengths have enabled operators to capture rental growth, which has been a particularly attractive factor during the recent inflationary environment. 19% of leases last for 3 months, with 48% of tenants staying for less than 12 months.[ix] The latest rental data shows that rates have increased by 4% in 2022 while occupancy stayed stable at 83.3%.[x]

The relative nascency of the sector, when compared to more mature storage markets like the US and Australia, points toward sustained future growth as consumers and businesses become aware of the sector. Compared to the US, the self-storage industry in Europe is still in its infancy. There is only 0.25 sqft of lettable storage space per capita in Europe compared to 9.4 in the USA. It is estimated that just 4% of the UK population have used self-storage in the past, compared to 38% in the USA.[xi]

We believe the next phase of alternative investment is upon us. Strong fundamentals that have characterized these alternative sectors for several years are now supported by a number of factors such as increased liquidity and a wider range of institutional-quality opportunities that create a compelling investment proposition in new alternative sectors. While high barriers to entry remain and operational expertise is required, Harrison Street seeks to leverage almost 20 years of operational know-how in these sectors to capitalize on the opportunities they provide, both now and for the future.

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[i] FLAP-D defined as Frankfurt, London, Amsterdam, Paris and Dublin.
DataCentreHawk
[ii] DataCentreHawk
[ii] Eurostat Forecasts
[iv] Green Street
[v] Green Street
[vi] CBRE
[vii] Fedessa 2023 Report
[viii] SSA 2023 Report
[ix] SSA 2023 Report
[x] SSA 2023 Report
[xi] Harrison Street Research