

The art of living: a new equilibrium for Europe?

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As millions of Europeans were asked to work from home to help curb COVID-19 infection rates, the long running debate on the optimal work-life balance was finally put to the test. Many questioned how and where they want to live, along with the quality of their living space. If spending more time at home becomes the norm, how well does this space now fit my lifestyle?

Like any major shock, this pandemic has changed the course of certain trends, and reinforced others. Rental decisions, whether upsizing or relocating, continue to be driven by individual circumstance. However, a more flexible approach to home working has changed both consumer needs and the timing of certain decisions.

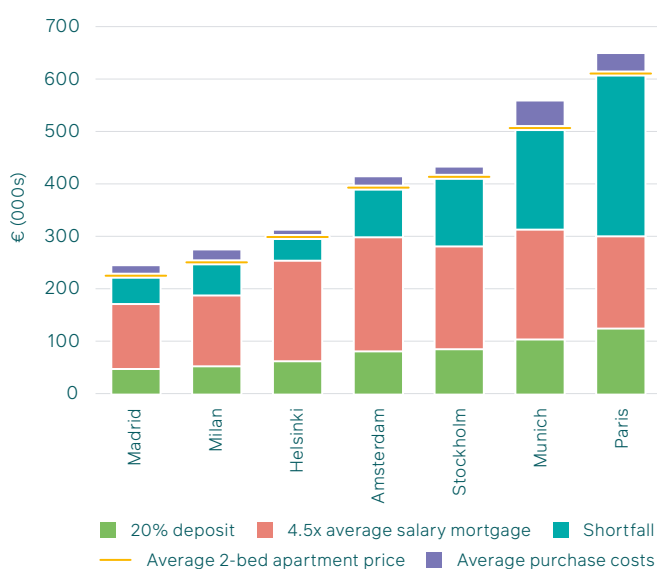
While some may look for homes in suburbia sooner than intended, cities are unlikely to fade into irrelevance. Their prosperity has always stemmed from innovation, imported through younger generations and skilled workers that are drawn to the social and professional prospects offered by city living. This symbiotic relationship will continue long beyond the pandemic, in our view.

The young and carefree remain young and 'house free'

Europe's cohort of renters are still driven by many familiar dynamics. 'Out of reach' house prices continue to dissuade younger generations from buying. Put simply, not enough housing has been built. Record low mortgage rates do little to help first-time buyers if they still require a 20% deposit to make repayments affordable. With a typical loan of 4.5x earnings, most prospective buyers still face a shortfall of between €40,000 – €300,000 for a two bedroom apartment¹. Alongside the extra burden of purchase costs – just 4% in Finland, but upwards of 10% in Germany – the barriers to home ownership are getting higher, not lower.

These hurdles often form the basis of a country's housing culture. Home ownership in Germany is just 45%, and only 25% among 30 to 39 year olds²; the typical demographic for first-time buyers. Aside from the challenge of buying, in Germany, selling a house within 10 years of ownership triggers a capital gains tax of 25%. Buying a house here is often for life, not simply to get on the housing ladder.

Figure 1: 'Out of reach' house prices continue to dissuade younger generations from buying



Source: OECD, Eurostat, EMF, Global Property Guide, M&G Real Estate, 2020.

¹See Figure 1.

²Empirica, Landesbausparkassen (LBS), 2018.

Renting for longer can often mean compromising less

German rent controls also make renting more appealing, with longer tenures and stricter rules around rental uplifts offering greater security to the tenant.

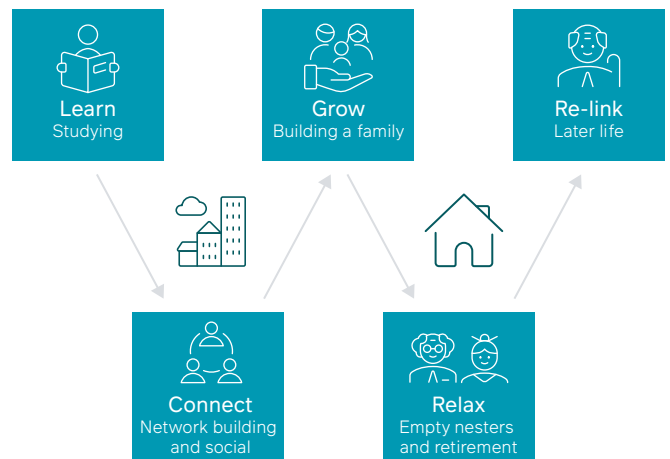
By comparison, lower costs, tax incentives on mortgages, and culture, all lend a small but helping hand to home ownership in markets like Spain, the Netherlands and Finland (where rates of home ownership are higher than 70%³). Needless to say, the average age of a first-time buyer in Germany, at 34⁴, is five years older than in Finland.

Equally, the last decade has seen a shift in the renting psyche. While home ownership is still an aspiration for many, many Europeans are also happy to rent for longer, especially if it better suits their lifestyle. Living in a well connected, professionally managed apartment with modern amenities, has unsurprisingly become more enticing than buying a 'shoebox' flat overlooking Paris' outer Périphérique.

The rental lifecycle is relatively universal across Europe

The path a renter takes tends to mirror key life stages. Once we leave our parents' home, we choose either study or career progression. These two sub groups of renters have similar traits. They generally have two demands: education and connecting with like-minded people, either socially or professionally. At this stage in life, the primary emphasis is on proximity, be that close to university, work or 24-hour nightlife. Thereafter, our needs change. As we move along the lifecycle and build a family, we tend to focus on space, security and schools. Childcare provision and local community begin to impact our housing decisions.

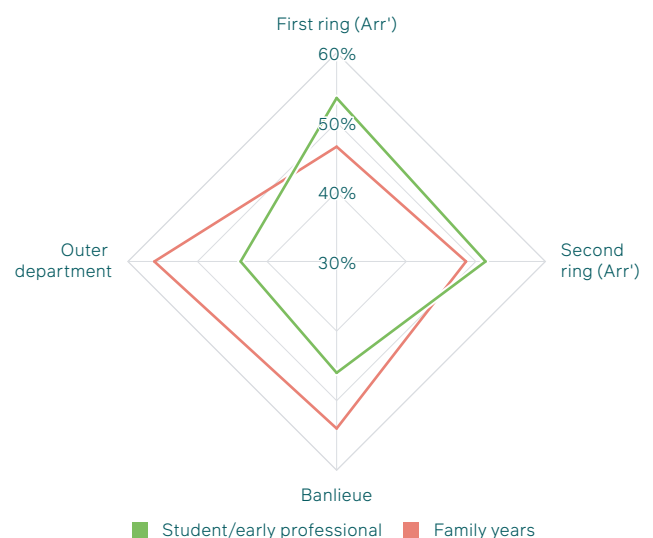
Figure 2: The five pillars of living



Source: M&G Real Estate.

Demographic trends illustrate this clearly. Analysis of European capitals reveal that inner-city suburbs are 'young' and getting younger. Paris' 5th and 11th Arrondissements – two first ring districts – are most popular with students and young professionals. Home to Université de Paris and packed with culture, trendy bars and restaurants, young adults make up a sizeable chunk of their population. This proportion is growing. By comparison, Paris' banlieue are dominated by families and young children. These suburbs are greener, more relaxed and offer family-sized apartments with an abundance of schools. This dynamic is not unique to Paris, but rather a product of lifestyle choices as we age.

Figure 3: Inner-city suburbs are 'young' and getting younger



Source: UrbiStat, 2017, INSEE, M&G Real Estate, 2020. First ring (Arr'); 1st to 11th. Second ring (Arr'); 12th to 20th. Banlieue; Seine Saint Denis, Val de Marne, Hauts de Seine. Outer department; Val D'Oise, Seine et Marne, Essonne, Yvelines.

³Eurostat, 2019.

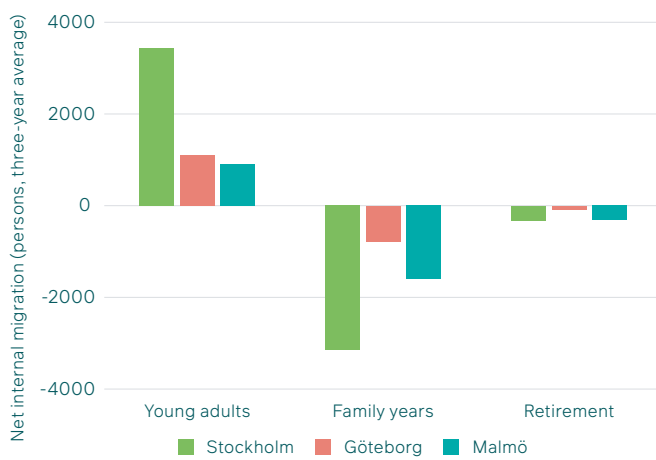
⁴ING Money, November 2020.

COVID-19 has accelerated the space versus proximity trade-off

When it comes to most living decisions, there is typically a trade-off between the cost of space and proximity to work, community or education. With shifting priorities, the average commute tends to lengthen as people grow older and start families. But we believe COVID-19 has accelerated the tipping point of this trade-off, based on the option to work more flexibly. Putting up with a nightmare commute becomes an easier sacrifice if it's done fewer days each week.

This trade-off is not necessarily new. Younger generations and skilled migrants have been firmly behind the growth of cities for the last decade. They have even made up for the loss of older families, and their quest for suburbia. Sweden has some of the fastest growing cities in Europe, but has also been shedding families at a sizeable rate.

Figure 4: Younger generations have historically compensated for the loss of families in cities



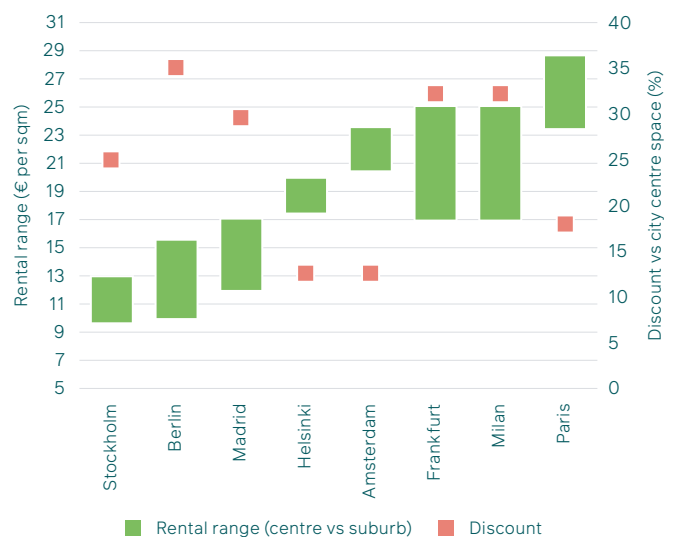
Source: SCB, M&G Real Estate, 2020.

Commuter suburbs are increasingly top of the family wish list

In Stockholm, the waiting list to get a rent controlled apartment extends over 10 years. Most renters are forced into short-term, sub-let space as a result, often paying double the regulated rent. With house prices also up 80% since 2010⁵, families looking for more space have little choice but to search further afield. This has a major consequence. Urban commuter suburbs, like Sollentuna or Farsta, are now increasingly top of the wish list.

Lifestyle migrations are fuelled by similar drivers in most cities. Despite rising house prices, disposable incomes have only risen so far since the 2008 crisis. Getting more space for less money is increasingly difficult for those unwilling to relocate. For those that do, the average renter can save anywhere between 10% and 40% of monthly rental costs if they can tolerate an extra 30-minute commute. It comes as little surprise, therefore, that submarkets like Potsdam in Berlin, or Vantaa in Helsinki, have seen populations swell in the last decade.

Figure 5: An extra 30-minute commute can save renters up to 40% of monthly rental costs



Source: Catella, national statistics, local property agencies, M&G Real Estate, 2020.

⁵SCB, 2020.

Connectivity and density impact our relocation choices

A city's density and connectivity can determine where a renter may choose to settle. In high density markets, the optimum space can sometimes only be found by taking on a much longer commute. While in Amsterdam more space is often just a cycle ride away, in Barcelona – with an urban area nearly 2,000 km² larger, and a city core three times as crowded – many target the city's sprawling urban submarkets. Mataró or Sant Cugat, for example, reside 20-30km from the city centre, but are popular alternatives for those looking for additional space.

Yet the incentive must also be greater, since cutting ties and relocating becomes physically more demanding. For the investor, this can open up new opportunities which are further from the central core, with a focus on larger family residential housing and corresponding amenities.

Perhaps if we move to a world of fewer days in the office, this could spark a trend of gradual de-densification, with less demand for inner city style housing. But let's not forget that most people are highly social. They enjoy the buzz of city living; the proximity to theatres, exhibitions and culinary variety. Work is, after all, not everything.

Cities also have an uncanny way of reinventing themselves, and drawing people back in. Those who migrate out to the suburbs are replaced by new generations and new workers, driven by different priorities. In this regard, cities are in a constant state of rejuvenation. They will surely maintain their relevance long after this pandemic is over.

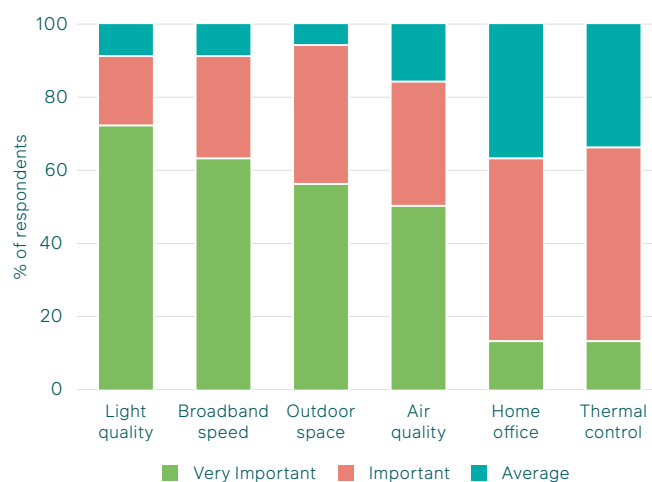


Shared values and cultural nuances define the end product

Understanding commuter and migration patterns is an important aspect in building a successful investment strategy in the real estate 'living' sectors. But renting is driven by consumer needs. Living space, whether for students, professionals or retirees is nuanced and varies from city to city. Like all consumer products, knowing your end user is crucial. Understanding how culture, service requirements or energy standards differ can help to keep occupancy high and turnover costs low.

Of course, Europeans also have many shared values. People inherently look for similar things. M&G Real Estate's own residential survey on tenant preferences showed that light and air quality are top concerns when it comes to housing. Healthy living, both physical and mental, is now at the forefront of our lifestyles, with increased emphasis on the importance of community during lockdown. If we do see a lasting shift in working patterns post COVID-19, it will not just be corporate office space that urgently needs to address these requirements. Residential landlords have an equal responsibility. Residential renters are generally footloose and fancy free. They will quickly vote with their feet if living standards fall short.

Figure 6: Healthy living is now at the forefront of our lifestyles



Source: M&G Real Estate Living Survey, 2020.

Services and amenities must match consumer need

Having access to outdoor space, whether shared or private, can be a decisive factor for tenants. In dense cities like Milan, Paris and Madrid, ensuring sufficient balcony space can often compensate for a lack of public green space. Moving out to the suburbs, investors need to be more inventive. Private garden or roof space, or a communal park within a wider scheme, can make a big difference.

How we move around our cities can also determine aspects of a scheme's design. Europe's electric car market is second only to China's, by sales. While consumer appetite varies, modern housing needs to accommodate this demand. Germany has grand ambitions for 10 million electric vehicles on the road by 2030 – around 20% of total passenger vehicles. Charging facilities should be actively incorporated into residential designs.

In smaller cities, shorter journeys and 'greener' modes of transport are more common. Copenhagen holds the crown as the world's most cycle-friendly city. In 2020, some 62% of commutes were made by bicycle⁶. Its popularity ranges from students on hire bikes, to families with cargo bikes, and seniors on e-bikes. Insufficient internal bike storage – the top scoring amenity in our survey – or limited bike parking and hire options, could prove extremely costly.

Figure 7: Storage is valuable to tenants

M&G Real Estate Living Survey 2020

	Amenities score (out of 5)	
	City Centre	Suburbs
Bicycle storage	3.7	2.5
Car parking	3.5	3.6
Separate storage	3.5	3.0
Electric vehicle charge points	3.0	2.7
Gym	2.9	2.7
Postal concierge	2.8	2.4
Communal lounge space	2.5	1.8
Dining facility	2.2	1.7
On-site staff	2.1	1.8

Source: M&G Real Estate Living Survey 2020.

Housing across Europe can also take on more unique features of appeal, dependent on culture and climate. These range from low cost facilities to more premium services; providing electrical heat connections to prevent car engines freezing in Nordic countries, or building in private saunas, for example. Understanding how home office requirements may differ is also important – Italy and Sweden have the lowest and highest levels of flexible working respectively. By the same token, different cultures can imply different tenant behaviours. In Germany, given renting is more common later in life, taking your kitchen with you when you leave – sink and all – is not unheard of. Landlords must take into account these nuances. Ultimately, it is not about having the 'best' amenities, but matching those amenities to customer needs, location and price point.

Sustainability is increasingly at the heart of our rental choices

In the past, how we consume energy and by how much, hasn't always been a top priority for the average renter. But the 2020s will see a major shift in this mentality. The biggest force for change in any consumer's world is cost. More working from home means more electricity use, more heating and air conditioning. Average household energy bills have already risen by a third since the start of COVID-19. The colder winter months will see this increase further. Demand for efficiency in our homes will inevitably rise, in tandem, to help curb these costs. What's more, younger generations have become accustomed to different standards. Sustainability is ingrained in their vocabulary. A decade from now, it will be this group that investors need to please most.

In many markets, government regulation is driving this change before consumers. Cities are also 'going green' off their own back. Helsinki has a carbon neutral target by 2035. Energy efficient housing is central to this plan. Solar panel or geothermal heating systems in new build student housing and multi-family housing are verging on industry norms. Helsinki is not alone. The EU is targeting 100 carbon neutral cities by 2030. Existing housing stock across Europe is in need of a rapid upgrade to achieve this.

⁶Copenhagenize Index, 2019.

Institutions are well placed to drive innovation

More quality, affordable homes are sorely needed to meet living requirements at every stage of the lifecycle, and governments are committed to tackling this urgent social conundrum. However, pressure on public spending represents a growing opportunity for institutions to bridge the gap, driving innovation in both product and customer service.

We see the real estate living sectors as the clear strategic winners of the 2020s. But unlocking their potential comes with challenges.

Renters now expect more from their living space, at a cost they can meet. This requires careful consideration of the overall 'housing experience', from sustainable design that promotes wellbeing, to the level of professional services and amenities. Yet the intricacies of customer preference vary from city to city. Getting this right means knowing your consumer base; understanding how they move around cities, their optimal lifestyle, and the tipping point of their decisions. It is these nuances that shape best quality living space, tailored to meet future demand. □

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