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PERE Europe: 'Disruption has started, and it's here to stay'

Trends that have been shaking up the private equity real estate industry, such as co-working and artificial intelligence, are set to become a regular part of investing in cities, speakers said on Wednesday.

Private equity real estate firms are continuing to capitalize on the growth of global cities such as London, but with urbanization comes many different sources of disruption, said delegates at the PERE Europe 2018 conference in London on Wednesday.

"I don't think you're going to stop the trend toward urbanization," said Joanne McNamara, head of European investments at Oxford Properties, speaking during the conference's opening panel. "The UK has grown by 10 percent in population since the start of the 21st century, but most of the cities have doubled in size."

The issue is how to make cities more affordable as they continue to become more attractive, said McNamara, whose firm which has put its regional focus on the cities of Berlin, Paris and London. "We just have to use things a bit differently. That's what we're focusing on, how we use space – whether it's through co-working or something else – so it becomes more affordable."

She added: "From a co-working standpoint, I fully believe that it is something that's here to stay. The internet of things, being able to rent certain industrial technology and machinery, that's coming in as well. The disruption has started, and it's here to stay."

Co-working as a disrupter has directly had an impact on how office property owners view their space, said Robert Rackind, head of EQT Real Estate: "Now if you don't offer flexibility, such as co-working, your building may not lease as well. Offering that flexibility is absolutely key."

That said, Rackind believed part of the demand for co-working space was the current lack of office supply. "But if we move into oversupply, the co-working phenomenon may die out a little bit," he said.

Other private equity real estate investors also anticipated that the current demand for co-working space may decline in the future. "We're starting to see that insatiable appetite moderate as we move through the economic cycle," said Simon Durkin, head of research at BlackRock Real Estate. "Less than 10 years ago, we struggled with underwriting the serviced office space. It not only creates a more vibrant atmosphere, but it allows big companies to flex as they need to."

Consequently, while investors have embraced co-working in their properties, they have done so in a measured way. "It's capturing upside in a good market but adjusting the way we generate revenue in our buildings," said McNamara. "We can generate income when they're doing well, and when they're not, we have the flexibility to move them around. A fully let co-working building is in effect not what we're looking for. We're looking at the 10-20 percent bracket."

Similarly, British Land launched a flexible working platform called Storey last year to target small- and medium-sized businesses that have grown out of co-working spaces. David Lockyer anticipates that Storey will eventually become about 10 percent of the firm's office portfolio.

Rackind wondered whether changes in the tech industry – which is considered a major driver of demand for coworking space – would ultimately affect the design of buildings in the long run. "If this tech boom is going to bust, are buildings going back to being boring buildings, or are we going to stay in age of pool tables and running tracks on the roof?"

Lockyer believed such building features were not going away anytime soon: "We're creating buildings that can accommodate different types of fit-out. The financial sector, the tech sector, they're not so dissimilar. People are people."

A bigger disrupter than co-working, however, is artificial intelligence, which would have a far more significant and far more rapid impact on real estate demand than people may expect, as humans will be replaced by machines in certain roles, said Durkin.

"The biggest risk our business sees is AI, in terms of where the jobs are and where people need to be," McNamara agreed. She noted that one top brokerage firm no longer has internet on their phones and are not allowed to forward emails anymore because of issues surrounding data protection and cyberattacks.

At the end of the day, cities will continue to adapt to the disrupters of the times, said Lockyer. "Cities are always on a journey," he said. "They reinvent themselves over a period of time and adapt."

The panel session, "Private real estate: the age of the city," was moderated by Darren Rogers, partner and head of European real estate at law firm Fried Frank.