

Research & Strategy, Alts

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SPOTLIGHT ON: DEVELOPMENT

BUILDING TOMORROW'S CORE ASSETS

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Europe's next real estate cycle is likely to be shaped less by excess supply and increasingly by scarcity. Development activity has fallen sharply as higher construction and financing costs, planning constraints and greater investor caution have reduced the viability of new projects. With pipelines contracting across offices, living and logistics, today's lack of development is likely to become increasingly visible later this decade, supporting rental growth in markets where occupier demand remains resilient.

At the same time, high replacement costs have raised another hurdle for new supply. This creates opportunities for well-located new developments and refurbishments, particularly where a shortage of modern space allows differentiated assets to command premium rents and potentially establish new rental benchmarks.

This scarcity is becoming more important as occupier requirements evolve. Sustainability, efficiency, amenities and operational quality are widening the divide between modern assets and ageing stock, making obsolescence a growing risk. Refurbishment and repositioning will therefore be critical alongside ground-up development in delivering the next generation of investible assets.

Opportunities will remain highly selective, with the strongest potential in supply-constrained living markets, prime offices in leading cities and strategically located logistics and industrial assets. High replacement costs are lifting the rental threshold for new development with new schemes requiring higher rents to be viable. Limited competing supply is increasingly allowing the best assets to achieve these premium rents, and is expected to push prime rental benchmarks to new record levels.

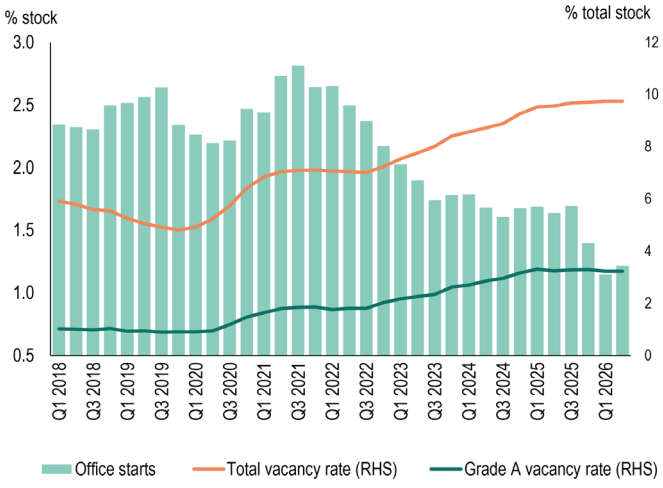
> // Tomorrow's core assets will emerge from today's scarcity, with rising replacement costs and limited new supply creating the conditions for the best schemes to push rents to new levels //

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The next cycle will be defined by a lack of new supply

Europe is moving from an era of development-led supply growth towards one characterised by increasing supply scarcity. The defining characteristic of today's market is increasingly the growing imbalance between future supply and occupier demand. This is driven by a multitude of factors which include local planning constraints, higher financing costs and more stringent requirements from lenders and finally fewer players with development expertise and capability to navigate this uncertain environment. But overarching all of this is a more cautious investment environment, where heightened uncertainty and a risk-off mindset have reduced developers' and investors' willingness to commit capital to new speculative projects. Combined with elevated construction costs, this has resulted in a sharp contraction in development starts, permitting activity and future delivery pipelines. Projects that would have proceeded only a few years ago have been postponed or dropped altogether resulting in a widespread decline in development starts, permitting activity and future delivery pipelines. This trend is evident across all major real estate sectors, but notably offices, living sectors and logistics, where development activity remains well below levels seen before the inflation shock. Historically, development has often amplified market cycles. Strong occupier demand encouraged new supply, which eventually contributed to oversupply and weaker performance.

Building starts & vacancy rates Europe

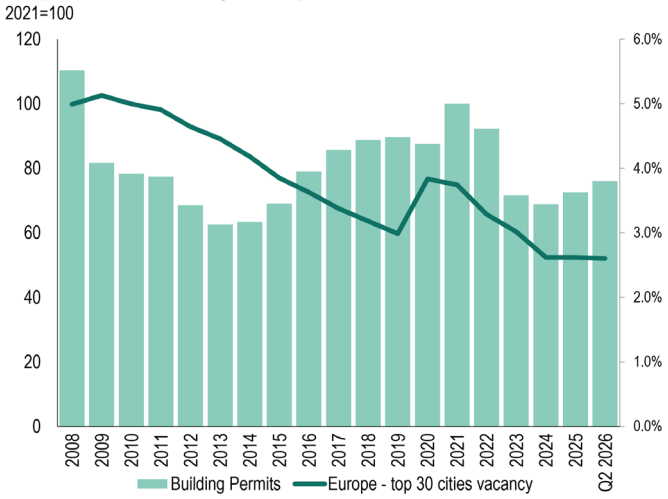


Source: PMA, CBRE, BNPP AM Alts, data as at Q2 2026

Today's environment appears different. Instead of overbuilding, Europe increasingly faces the risk of underbuilding. Development pipelines have contracted sharply across multiple sectors while occupier markets have generally proven more resilient than many expected. The implications of this shift are significant. Real estate is a long-duration asset class, and development decisions taken today determine the stock available to occupiers and investors many years ahead. As a result, reduced construction activity over the last three years is unlikely to be felt fully until later this decade, when the shortage of newly-completed space becomes more apparent. A significantly reduced development pipeline means that new and refurbished assets should enter a more supply-constrained market environment, supporting rental growth not only through economic recovery but also through a lack of competing supply.

Importantly, not all future supply needs to come from ground-up development. Refurbishment and repositioning strategies are increasingly becoming a critical source of high-quality space, particularly in sectors where well-located existing assets can be upgraded to meet modern occupier requirements. In many city centres, the ability to transform existing buildings may prove just as important as the ability to deliver new schemes. As development pipelines contract, successful refurbishment projects can effectively create new supply while benefiting from shorter delivery periods, lower planning risk and, in many cases, a lower environmental footprint than new construction.

Europe residential vacancy rate vs permits



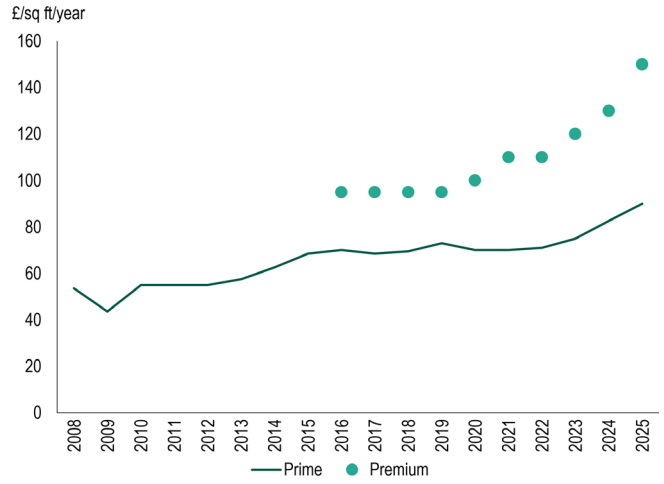
Source: GreenStreet, Eurostat, BNPP AM Alts, data as at September 2026

Replacement costs have shifted the economics of new supply

The rise in construction costs over recent years represents more than a cyclical challenge. Construction inflation, stricter environmental requirements, higher specifications and increased financing costs have raised the cost of delivering new space across many sectors and locations. Development remains viable in selected markets, but the hurdle rate for new projects has increased, which limits the pace and magnitude at which supply can respond to improving occupier demand.

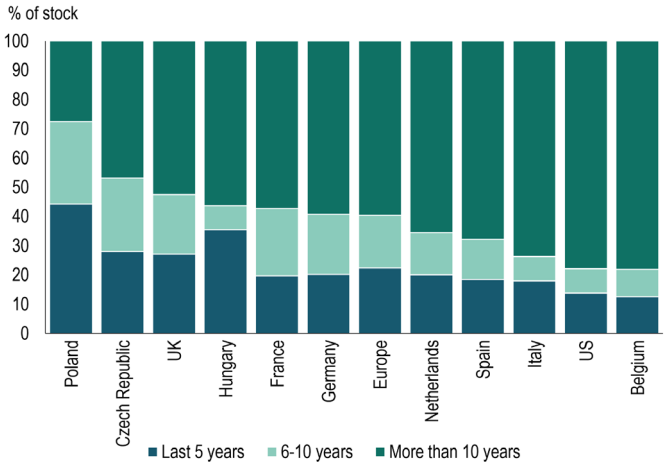
Importantly, existing assets can no longer be replicated at the costs that prevailed only a few years ago. As a result, future projects require either stronger rental growth assumptions, or significantly repriced land values to achieve the required returns. This effectively raises the hurdle for new supply and limits the pace at which future development can respond to improving market conditions. The same economics are improving the relative attractiveness of refurbishment. For well-located assets with good connectivity and flexible floorplates, targeted capital expenditure can offer a more competitive route than demolition and redevelopment. This broadens the opportunity set and provides an additional pathway for delivering future-proof space into markets where new supply is limited.

London City office rents



Source: BNP Real Estate, BNPP AM Alts, data as at Q2 2026

Age profile of logistics stock



Sources: CoStar, JLL, CBRE, PMA, BNPP AM Alts, data as at September 2026**

For investors willing to pursue development, high barriers to new supply provide a degree of downside protection. Scarcity reduces the risk of oversupply, gives occupiers fewer comparable alternatives and strengthens landlords' pricing power. This dynamic is visible across several sectors, suggesting that future performance is less driven by economic expansion, but increasingly by structural supply constraints.

The scarcity of new development also creates the potential for genuinely differentiated schemes to establish new rental benchmarks. Where occupiers have few comparable alternatives, newly delivered buildings in the best locations can command rents materially above those achieved by existing stock, particularly where they combine high sustainability standards, modern specifications and strong amenities. Rather than simply following prevailing prime rents, the best projects can therefore push the boundary of what occupiers are willing to pay, supporting development viability and creating a valuable first-mover advantage. City of London provides a clear illustration of the growing value of differentiation. While prime rents have risen from around £70/sq ft in the late 2010s to around £90/sq ft in 2025, premium rents have increased much more sharply, reaching around £150/sq ft. This widening gap suggests that occupiers are increasingly willing to pay a substantial premium for the best space, rather than simply following the wider market. For developers, this creates an opportunity to deliver buildings that can establish new rental benchmarks well above prevailing prime levels. In a market where new high-quality supply is increasingly scarce, this premium can play an important role in supporting development viability despite elevated construction and financing costs.

Obsolescence is becoming a greater risk than oversupply

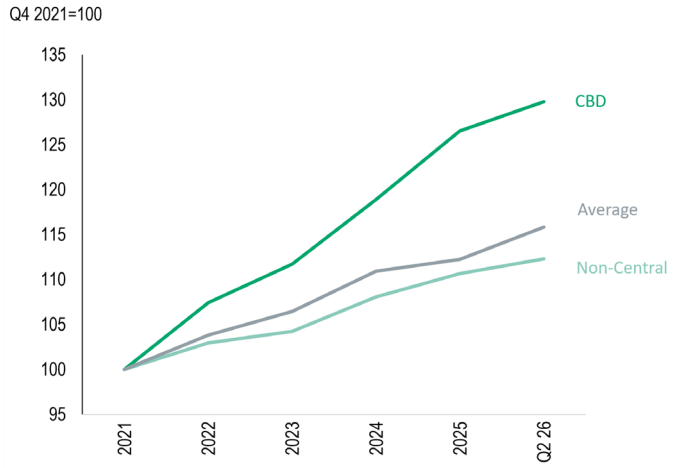
Across real estate sectors, occupier requirements have evolved significantly in recent years. Sustainability, energy performance and certification, wellness, flexibility, accessibility and operational efficiency have moved from desirable attributes to essential features. As a result, a growing proportion of Europe's existing stock faces increasing risks of obsolescence and we are seeing more occupiers willing to push the envelope in terms of the rent they are willing to pay for the right type of space.

The office sector illustrates this trend most clearly. Occupiers are becoming increasingly selective and continue to prioritise modern, highly sustainable and amenity-rich buildings in prime locations. This has contributed to a growing divergence between prime and secondary assets, with demand concentrated in a relatively small pool of high-quality buildings. This is evident in the widening of rents achieved by top quality recently developed space compared to more second hand buildings which are increasingly at risk – barring a capex repositioning strategy. The increasing deployment of artificial intelligence (AI) could reinforce this trend. While AI is expected to automate many routine tasks, its greatest value is likely to be realised within highly collaborative, knowledge-intensive environments where innovation, problem-solving and idea generation remain fundamentally human activities. As organisations focus on attracting talent, and capturing productivity benefits, workplace quality is likely to become an important source of competitive advantage. The best offices are therefore likely to act as hubs for collaboration, training, innovation and culture, reinforcing demand for high-quality space in prime locations. The future office market may not be characterised by a shortage of office space overall, but rather by a shortage of the type of office space occupiers require.

The same dynamic is evident across the living sector. Residents place greater value on flexibility, convenience and service-rich environments, creating demand for housing formats that are often underprovided for within existing stock. Similarly, in logistics, occupiers require highly efficient assets capable of supporting modern supply chains, automation and advanced manufacturing processes.

Refurbishment, redevelopment and selective new development will all play a role in addressing these challenges. In offices, many well-located secondary assets can be repositioned successfully, while in logistics and industrial sectors redevelopment is often the more effective route to delivering modern occupier specifications.

Office rents in Europe by quality and location



Source: CBRE, BNPP AM Alts, data as at Q2 2026

The key investment challenge is identifying which assets can maintain relevance and which are likely to become increasingly obsolete despite further capital expenditure. Development should therefore be viewed not only as a growth strategy, but also as a replacement strategy aimed at delivering the next generation of assets that occupiers require.

The strongest opportunities are concentrated in a small number of sectors and locations

A more favourable backdrop for development does not imply that all sectors and geographies offer attractive opportunities. Future performance is likely to be driven by selectivity rather than broad market exposure. The strongest opportunities will be found where structural demand drivers remain intact, supply constraints are severe and regulatory or political barriers to entry are high.

The broader living sector remains perhaps the most compelling opportunity. Housing shortages are a persistent challenge across many European countries and development activity remains insufficient to meet long-term demand. Population growth, household formation and affordability constraints continue to support demand for rental and owner-occupied accommodation across major cities. Beyond traditional residential markets, favourable demographic trends are also supporting demand for student housing, senior living and other operational residential formats. These sectors offer exposure to some of the most durable structural demand drivers within European real estate. The sector also has complex regulatory and policy constraints which remain key barriers to entry in some countries and navigating these is as important a route to success as capital availability.

As indicated earlier, prime offices also warrant renewed consideration. Although the sector continues to undergo structural change, demand for high-quality space remains robust in leading CBD locations. The ongoing flight to quality, increasing return-to-office expectations and rising focus on collaboration all support demand for modern buildings. For reasons already highlighted, AI may further strengthen this trend by increasing the importance of environments that facilitate innovation and knowledge sharing. The most attractive office opportunities are therefore likely to be concentrated in globally-connected gateway cities and knowledge-based economies where supply constraints are particularly acute.

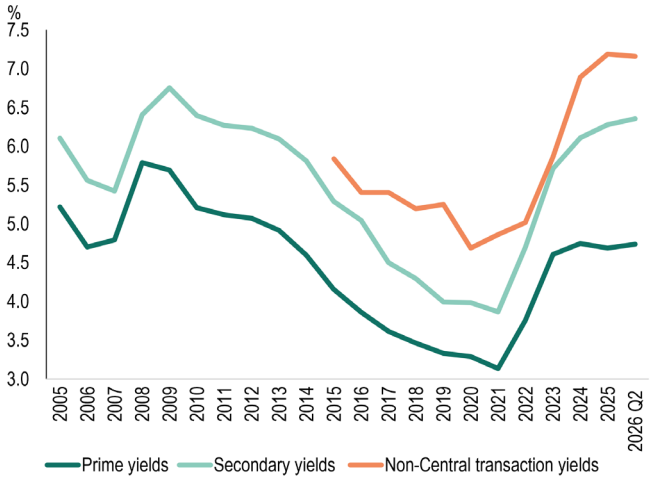
Logistics remains attractive where development is aligned with long-term structural change. Themes such as reindustrialisation, nearshoring, defence spending, infrastructure investment and advanced manufacturing are creating demand for logistics and industrial assets in strategically important locations. Unlike traditional cyclical demand drivers, these trends are linked to broader economic transformation and may continue to support occupier demand over an extended period.

Across all sectors, one principle remains consistent: quality of location matters. Future development should focus on supply constrained markets capable of generating sustainable rental growth rather than relying on yield compression to drive returns.

Liquidity is not disappearing, it is becoming more selective

Development often focuses on construction costs, planning risk and leasing assumptions while paying relatively little attention to future liquidity. Yet liquidity is becoming one of the most important considerations within today's market. The sharp decline in investment volumes since 2022 has fuelled concerns around liquidity, particularly in offices. However, lower transaction activity should not be confused with a permanent loss of liquidity. As capital returns to the market, liquidity is likely to become selective, concentrating on assets that align with occupier demand and investor requirements and capable of delivering resilient and growth-prone income streams. This distinction is particularly important for development strategies and for prime assets delivered into supply-constrained markets which align closely to these criteria. In contrast, ageing buildings facing cumulative obsolescence risks are likely to experience a shrinking buyer universe and discounted pricing, regardless of broader market conditions and despite short-term income flows which may superficially appear attractive.

European office yields by quality and location



Source: CBRE, PMA, MSCI Real Capital Analytics, BNPP AM Alts, data as at Q2 2026

Capital markets are increasingly mirroring the occupational markets. Just as occupiers are concentrating demand in the best buildings, investors are concentrating capital in assets that are expected to remain best-in-class over the long term. Asset quality is becoming a more critical determinant of liquidity outcomes. From this perspective, the greatest liquidity risk may not be associated with development itself. The larger risk may be owning buildings whose competitiveness deteriorates over time. Assets that fail to meet evolving occupier expectations may require significant capital expenditure and still struggle to attract tenants or investors. The distinction between prime and secondary assets may therefore become more important than the distinction between development and standing investments. The long-term winners are likely to be assets that remain aligned with changing occupier and investor requirements, regardless of how they were originally acquired.

DEVELOPMENT OFFERS A RARE OPPORTUNITY TO CREATE FUTURE CORE ASSETS

European real estate is undergoing a fundamental transition. Development activity has fallen sharply, replacement costs have increased materially, and a growing proportion of the existing built environment faces increasing risks of obsolescence. At the same time, structural demand drivers remain intact across prime office, living and logistics markets.

Taken together, these forces are creating a favourable backdrop for investors capable of delivering the next generation of core assets. The opportunity is not one of aggressive speculation or broad-based development exposure. Rather, it is a highly selective strategy focused on delivering scarce, future-proof assets into markets where demand is likely to remain resilient and new supply constrained. In many respects, the opportunity is becoming less about creating additional real estate and more about creating the type of real estate that occupiers and investors require, whether through selective development, refurbishment or repositioning of existing assets.

For long-term institutional investors, selective development therefore represents more than a search for development profit. It offers a route to creating scarce, future-proof assets at a time when rental growth, asset relevance and liquidity are becoming increasingly concentrated within the highest-quality segments of the market. As the next phase of the European real estate cycle unfolds, development may prove to be one of the most effective ways of enabling tomorrow's core assets.



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