European Commercial Real Estate Market – record investment volume

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August 2022

The European economy resisted well and continued to grow, namely due to the services sector and the gradual lifting of Covid restrictions, during the first half of 2022. Real Estate investors were confronted with a variety of challenges including higher inflation, increasing long-term interest rates and tightening financing conditions. Rising interest rates mechanically caused a compression of real estate risk premiums, which have begun to readjust. Nevertheless, real estate, and especially prime assets, should remain attractive given the indexation of rents on inflation. The shortage of building materials and limited stock, particularly of sustainable and energy efficient buildings, should continue to support prime rental values and asset valuations. Demand remains focused on central locations, and vacancy further develops in peripheries.

Alternative asset classes, uncorrelated with economic cycles, and particularly healthcare assets, continue to offer a relatively competitive risk/return profile and offer portfolio diversification opportunities.

European Real Estate Investment Market, record investment volume

The volume of commercial real estate investment in Europe reached a twelve-month high of €280 billion (as at end-June 2022). However, Q2 activity, particularly in southern Europe, slowed due to rising interest rates and stricter financing conditions. Investor demand has been focused on quality assets, in terms of ESG and technical credentials, whereas the soaring costs of refurbishment have weighed heavily on the demand for older and less energy efficient assets.

The office sector posted a twelve-month rolling investment volume up 9% as at end of June 2022 versus December 2021. The logistics and light industrial sectors performed well with a record investment volume of over €67 billion. Demand for this asset class is driven by anticipated increases in rental values given low vacancy and strong user demand.

Retail investment volumes have returned to pre-crisis levels, driven by higher yields.

Office yields have started to adjust

Q2 2022 was marked by a rapid rise in long-term interest rates, which mechanically caused a compression of the real estate risk premium. Real estate yields have since started to readjust. The French and German markets, where yields were the lowest, were the first to experience a rapid but moderate correction in their yields. At the end of June 2022, prime office yields were however still below 3% in Paris and the main German cities. The rise in yields is expected to

be more pronounced and probably to last longer for secondary assets, especially in Southern Europe

Office take-up trends

Despite headwinds, take-up* across Europe continued on its positive trajectory and rose by 46% year-on-year (as at end-June 2022), exceeding its ten-year average by 3%. All the main European cities posted positive growth in take-up over a twelve-month period with the exception of Amsterdam which saw a slight drop in demand (-3%). Dublin, London and Lille have seen their take-up more than double over the last twelve months (as at end-June 2022).

Immediate office supply in major European cities remains stable over the past year, albeit at a relatively high level. However, rapidly rising construction and financing costs should limit future supply and may contribute to a decline in vacancy in the medium term.

Beware of rental value trends, submarkets behave differently

The health crisis and the development of teleworking have altered the dynamics of the real estate market. Previously and broadly speaking, an overall increase in vacancy led to an overall decrease in rental values. Today, it is important to recognize that submarkets can behave differently, and centrality is a determining factor of rental value.

Incentives on secondary assets, across all markets, continue to reach new records. Demand is more and more focused on centrally located, serviced and energy efficient assets. The demand for quality assets is further fueled by rising energy costs.

Low supply in Germany has continued to put upward pressure on German rental values. At the end of June 2022, prime rents stood at €510/m²/year in Berlin, €522/m²/year in Munich and €546/m²/year in Frankfurt, representing year-on-year increases of between 3% and 10%. **London** shows the **strongest year-on-year increase** (+13%) with rental values at €1,626/m²/year for the best assets at the end of June 2022.

Sources: CBRE, MBE, La Française REM Research

**take-up in the 12 main European cities: Brussels, Lille, Lyon, Paris, Berlin, Frankfurt, Hamburg, Munich, Dublin, Milan, Amsterdam, Madrid*