European Commercial Real Estate Market – record investment volume

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November 2022

In a high inflation environment, real estate continues to be favoured by investors as it offers a good hedge against inflation and constitutes a defensive long-term investment.

The European commercial real estate investment volume reached a record high in Q3 2022, in large part due to transactions initiated six to twelve months earlier. However, the deteriorating macro-economic and geopolitical environment and the volatility of financial markets suggests a different picture for year end.

Inflation has led central banks to pursue more restrictive monetary policies and property yields have started to rise, the magnitude of the rise is largely dependent on the quality and size of the asset as well as market vacancy.

Rental returns are expected to be the main driver of property performance. Greater selectivity is resulting in the polarisation of markets: strong demand for central locations and higher vacancy in peripheral locations. Alternative real estate assets (such as healthcare), uncorrelated with the economic cycle, 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 €283 billion (as at end-September 2022). The Retail sector recorded the largest growth (+23%), followed by logistics (+12%) and offices (+10%). The UK, Germany and France continued to attract the majority of investors with investment volumes of €66bn, €63bn and €34bn respectively over a rolling 12-month period.

While the market remains predominantly invested in offices, it is tending to rebalance towards other asset classes, against a backdrop of hyper-selectivity on the part of investors, i.e., a concentration of buyers on a few well-established markets.

Transaction periods are increasing because of the ongoing debate over the fair valuation of assets.

Office yields are on the rise

2022 has been marked by the tightening of monetary policies. The rise in risk-free rates, i.e., with 10-year German, French and UK bonds at 2.1%, 2.7% and 3.2% (as at 30 September 2022) respectively, has mechanically pushed up real estate yields. The extent of the rise varies across assets and markets. Paris, Brussels and Amsterdam experienced the highest year-on-year growth with +50 basis points (bps), followed by Hamburg, Berlin and Munch (+35 bps). The number of forced transactions remains limited but could increase as assets are refinanced.

A further slowdown in economic activity could lead to sharper rises in property yields, namely on secondary assets.

Lift-off of office take-up

The recovery of the European office rental market is confirmed. 12-month take-up* in Europe is up 36% year-on-year, exceeding the ten-year average by 5%. Major European cities posted an increase in demand, with Dublin, London and Munich leading respectively with growth of 178%, 83% and 56%. Amsterdam on the other hand, registered a fall in demand of 8% year-on-year.

Vacancy in Europe has begun to drop, namely in Munich, Madrid, Lyon, Brussels and Frankfurt. European markets are behaving at two speeds, i.e., central locations are facing high demand and offer low supply whereas peripheral locations are witnessing a fall in demand.

A widening divide between central and peripheral locations

Fuelled by the wide spread of teleworking, the office is considered more than ever a place to promote integration, collective thinking and creativity. Centrality remains key, as reflected by the growth of prime rents in the majority of markets. Year-on-year prime rents are up in all central locations in all major European cities. For example, London, Brussels, Berlin, Amsterdam and Milan all witnessed further increases in prime rental values over the third quarter. However, the gap continues to widen between grade A buildings in central locations versus those in peripheral locations. Peripheral locations are confronted with further downward pressure on rents.

Rising energy costs are focusing users' attention on energy performance. Given the lack of energy efficient buildings to meet this high demand, rental values could be higher for this type of property.

Sources: CBRE, MBE, Trading Economics, La Française REM Research

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