European Commercial – March 2024

SPOTLIGHT
Savills Research

European Investment
Q1 Preliminary Results

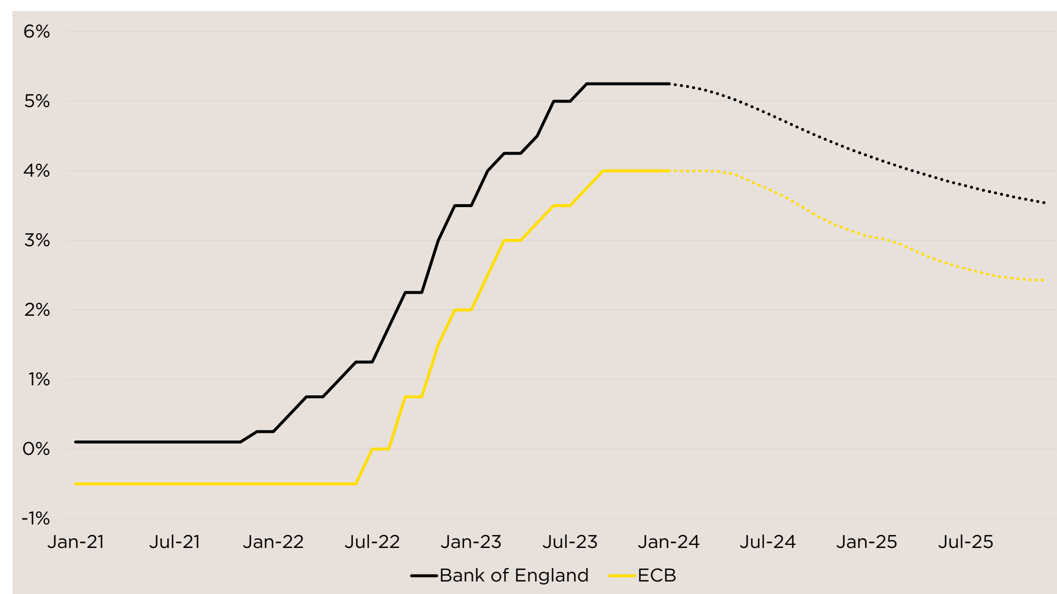
Investors awaiting summer ECB rate cuts

The eurozone is expected to remain in or close to recession in the first half of 2024 as high interest rates continue to impact consumption and tight fiscal policy persists. Capital Economics forecasts GDP to grow by only 0.10% in 2024. Historically, low unemployment rates are forecast to continue in the eurozone in 2024, helping to keep the market buoyed and dipping to their lowest recorded rate of 6.53% in 2025.

Despite inflation rates easing across Europe, estimated to be 2.60% in February according to the European Central Bank (ECB) and edging closer to the 2.00% target, strong wage growth and the tight labour market continue to heighten domestic price pressures. Hence, the ECB decided to leave the deposit rate at 4.00% in March. Looking ahead, Capital Economics predicts the first 25 bps cut in June 2024, with rates to fall from 4.00% to 2.75% by the end of 2025. Interest rate rises of 150 bps throughout 2023 had a direct impact on the cost of capital, and so the expected rate cuts this year will heighten real estate's investment appeal and bring players back into the market.

Europe will see several parliamentary elections in 2024, notably in Portugal, Belgium, Austria, the UK, and Romania. Some are likely to result in a prominent change in government and, therefore, political direction. As a result, many investors may continue to err on the side of caution until political stability is certain, continuing the wait-and-see approach that has so far characterised the real estate investment market.

Fig 1: Interest rates and forecasts



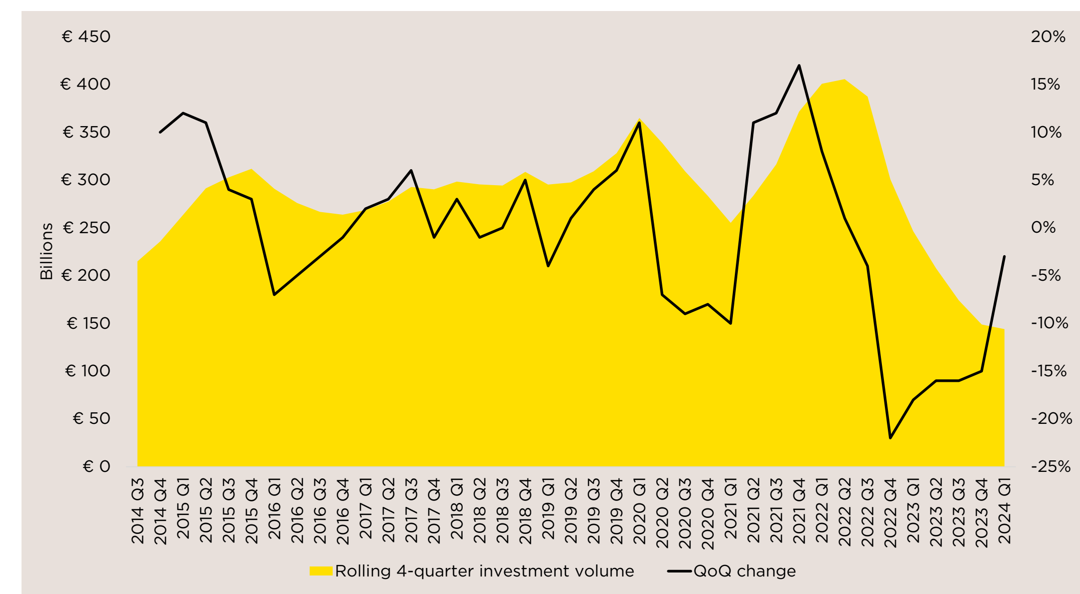
Source: Savills Research using Macrobond

Q1 indicators point to stabilisation

Preliminary results suggest that the European investment volume is expected to total approximately €34bn in Q1 2024, 12% down compared to the same quarter last year and 51% down on the previous five-year average. Although still declining, the investment curve is showing signs of stabilisation when compared to the steep downward trend over the previous twelve months. In Q1 2024, the rolling 4-quarter investment volume is to total €144bn, only 3% down on the €149bn last quarter. This represents a marked improvement compared to the average change of -16% observed over the preceding four quarters, suggesting a degree of optimism in the investment landscape. Core markets are likely to record the lowest decrease in Q1 investment volumes, with volumes on average only 5% down in Q1 2023, whilst other regions will likely record drops ranging between 20% and 30%. However, there are some bright spots across Europe, with a few individual countries predicting promising rebounds in investment volumes. Hungary and Italy anticipate increases of over 50% in Q1 2023, though largely off the back of low volumes transacted last year.

Higher debt financing means investors are pivoting to assets that provide the highest return through strong profit growth and favourable supply and demand fundamentals, with logistics and the living sector remaining the preferred asset classes. There is also a growing appetite for retail properties, which is likely to continue in 2024. As assets reach suitable re-pricing levels and interest rates begin to come down, we may expect to see REITs become more active towards the latter half of the year. Attractive valuations and the growth of certain asset classes that are deemed more defensive will work in favour of REIT fund managers. According to RCA, REITs made up only 2.9% of the European real estate buyer composition in 2023, down from the previous five-year average of 5.6%. Cash-rich investors, such as sovereign wealth funds who do not require expensive debt, are expected to continue to transact in the lower volumes bracket. We can expect more institutional investors to return to the market in 2024 with interest rate cuts. Reduced real estate allocation in 2023 due to rising government bonds turned many away from investing.

Fig 2: Rolling past 4-quarter investment volume



Source: Savills Research

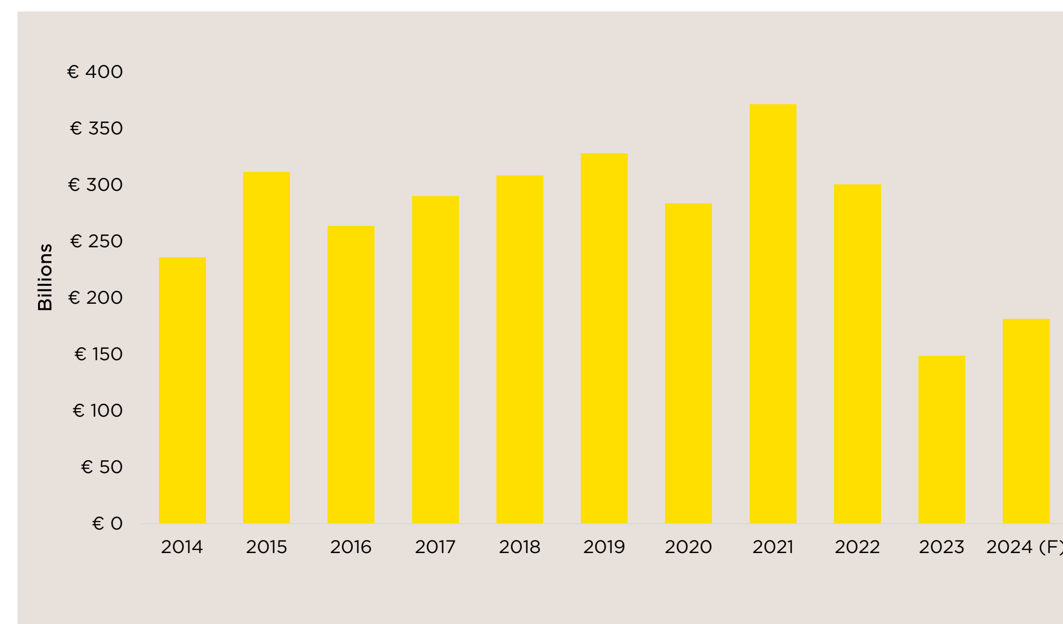
Full-year investment volume projected to rebound

As the gap between buyer and seller price expectations is beginning to close, helped further by expected ECB rate cuts later in the year, we expect a gradual resurgence in investment activity starting in H2 2024. We forecast the total European investment volume will reach between €177-182 billion by the end of 2024, marking a rebound in investment volume with an annual increase of 19-22%, up from the €149 billion reached in 2023. Despite some regaining confidence in the market in the second half of the year, the 2024 volume remains nowhere near the long-term average; our forecast end-year figures will be down between -36% and -38% against the previous five years. While we anticipate some easing of conditions in the debt market, obtaining loans for large or non-prime deals will remain constrained. Hence, large and high-leverage transactions will remain limited. CEE and the Nordics are anticipated to see the largest annual growth rates, with 28-40% and 17-35% expected at year-end, respectively, on the back of relatively low volumes recorded in 2023. Southern Europe follows, with an expected annual increase of 12-21% in investment volume, while core countries are forecast to see an annual increase of 16-19%, and the rest of Western Europe is forecast to see a 15-17% increase in investment volume by year-end.

Investors operating across borders will strive to capitalise on increasingly attractive pricing levels observed in various European jurisdictions. As a result, an uptick in cross-border investment activity is expected throughout 2024, led by European investors. The UK is poised to solidify its leading position as the primary beneficiary of cross-border investment, driven in part by the strong price adjustment experienced last year. Germany is also likely to pique the interest of cross-border investors seeking opportunistic deals amidst a looming wave of distress and forced sales. Presently, bidding competition in Germany is relatively subdued owing to muted domestic demand.

Sectors that benefit from strong occupier fundamentals, such as urban logistics and the living sector, are expected to fare well in 2024. Increased demand will continue to drive investment into both sectors. According to our European Investment Survey conducted in September 2023, logistics and residential stand out as the two sectors where investors are most likely to focus their investment intentions over the next 12 months. We also anticipate an increased investor appetite for retail assets on the back of the strong repricing the sector recorded over the past 24 months. Grocery stores, supermarkets and retail parks will continue to capture most of investors' attention due to their resilience. Finally, strong hotel investment activity is predicted to continue, notably fuelled by consolidation in the sector as some owner-occupiers are likely to exit.

Fig 3: Full year European investment volumes



Source: Savills Research

Yields largely expected to stabilise in 2024

The ability to achieve desirable yields on investments has been very complex in 2023, leading to strong outward yield movement across all sectors. The expected decline in central bank rates across Europe will provide a boost to investment activity in the second half of the year, which will generate a stabilisation of yields towards the end of the year or the beginning of next. Over the next twelve months, the majority of European locations are forecasting yields in most sectors to remain broadly stable, expecting little movement (0/10 bps or -10/0 bps) after continued decompression in 2023. In countries where we have seen strong repricing, such as in the UK, we can expect to see more inward yield movement over the course of the year.

Based on our internal survey (figure 5), multifamily and supermarkets stand out as the top-performing sectors, poised to experience a notable tightening of yields by 26 to 50 basis points. This trend will be supported by the positive sentiment around the living sector and essential food stores at present. Conversely, non-CBD offices and shopping centres are expected to witness a significant softening of yields exceeding 50 bps, owing to their higher investment risk, with dated assets in secondary locations feeling the most pressure.

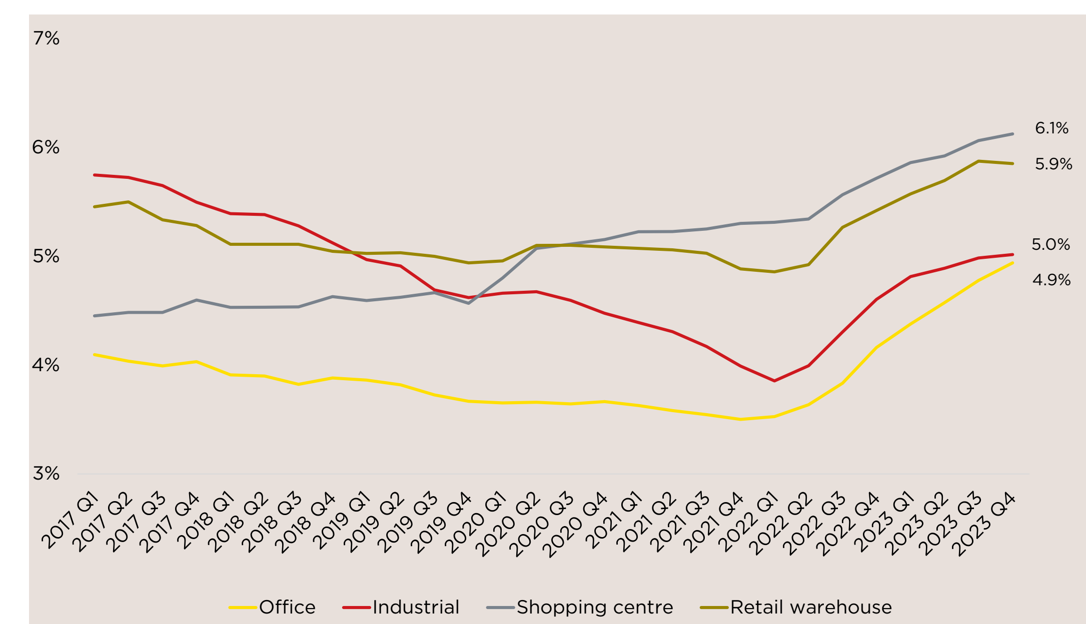
Delving further into the sector-specific yield forecast reveals some disparities in projections across different asset classes.

Robust underlying structural rationales for multifamily will bolster investment traction within the sector. Indeed, the inadequacy of new home supply to match escalating demand, exacerbated by the decline in new permits granted for residential construction across various markets, put upward pressure on rents. The resurgence of activity in the living sector will start exerting renewed pressure on yields in some locations. Across 20% of the European jurisdictions we surveyed, we anticipate a contraction in yields, while in 63%, we foresee minimal movement over the next 12 months.

Logistics yields moved out by only 41bps in 2023, with the competitive returns in the market continuing to attract investment. During the final quarter of last year, prime logistics yields mostly remained stable across Europe, experiencing a minor upward trend. On average, the European prime logistics yield stood at 5.0% in Q4 2023, 3 bps above the previous quarter. We believe that logistics prices have nearly bottomed out. 64% of our surveyed jurisdictions expect yields to stabilise; however, 32% still expect further outward yield movement.

Within the retail realm, we expect supermarkets and prime mass-market high streets to outperform other subsectors. We anticipate a minimal tightening of yield movement in 14% and 28% of our European jurisdictions, respectively, while other

Fig 4: Prime average yields

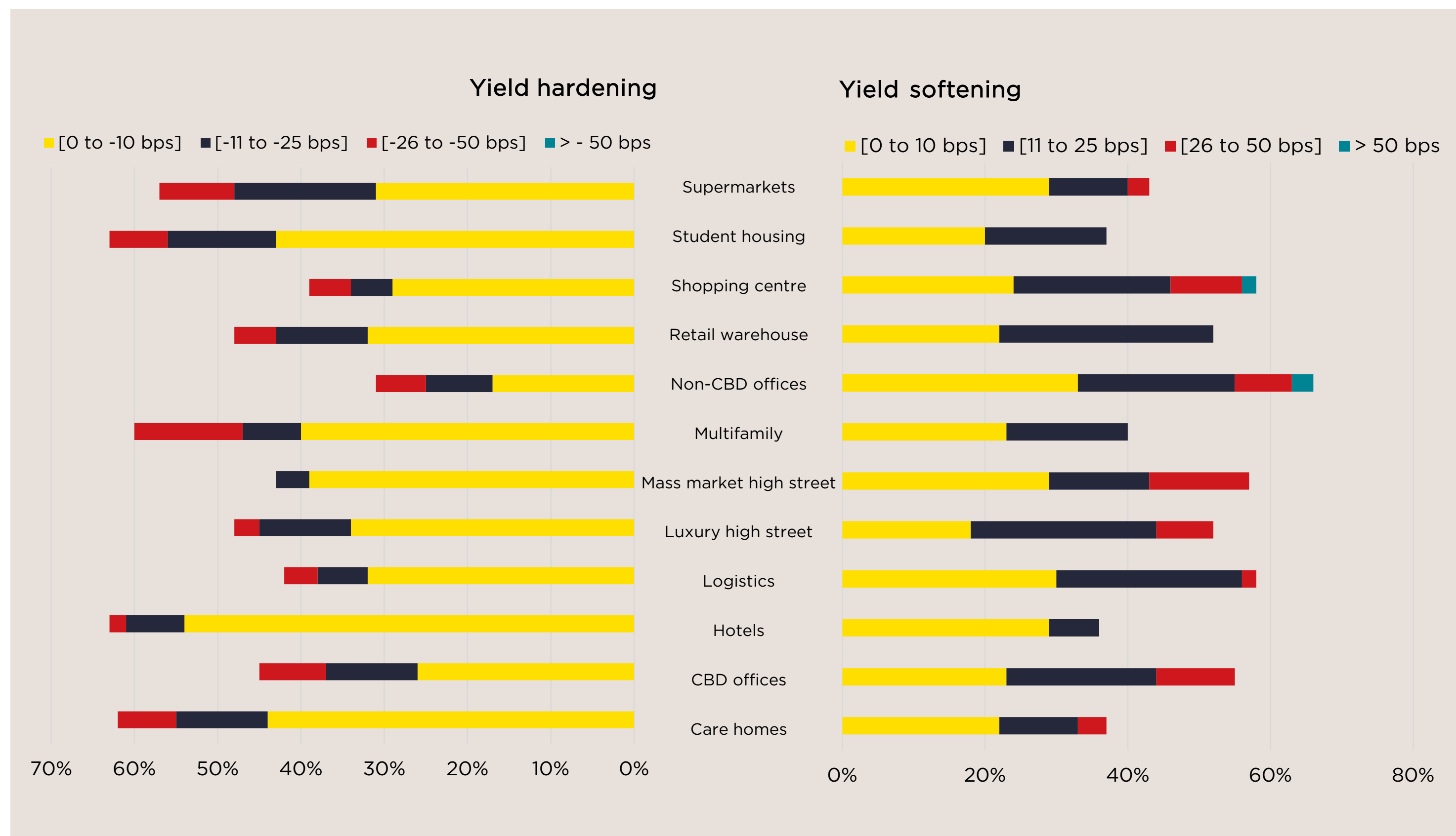


Source: Savills Research

areas generally foresee stabilised yields. However, for other subsectors like retail warehouses, luxury high streets, and shopping centres, the outlook is less optimistic, with over 30% of European locations expecting further softening of yields.

On average, the European prime office CBD yield moved out by 69 bps in 2023, the highest of all sectors. Owing to the negative sentiment that shrouded the office market last year, the significant re-pricing has positioned prime offices well for 2024. While core markets led the yield expansion at first, non-core markets began to adjust at a faster rate towards the latter half of 2023. While some locations are still forecasting further yield softening in the office sector, the return on core products is beginning to become more attractive.

Fig 5: How do you expect the current prime yields to trend in the next 12 months?



Source: Savills Research

Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

Tristam Larder
European Capital Markets
Director
+44 (0) 7870 999 673
TLarder@savills.com

Lydia Brissy
European Research
Director
+33 624 623 644
LBrissy@savills.fr

Georgia Ferris
European Research
Associate
+44 (0) 798 973 3368
georgia.ferris@savills.com

Savills plc: Savills plc is a global real estate services provider listed on the London Stock Exchange. We have an international network of more than 600 offices and associates throughout the Americas, the UK, continental Europe, Asia Pacific, Africa and the Middle East, offering a broad range of specialist advisory, management and transactional services to clients all over the world. This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. While every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.