

European Real Estate: Shelter Amid ‘Tariff-fying’ Times?

U.S. policy uncertainty means Europe might now be going from stagnant economic laggard to a potential oasis of calm for investors. Revisions to German spending plans should help to deliver a growth boost to the bloc in 2026 and beyond.

RESEARCH QUARTERLY



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Executive Summary

ECONOMY

- Trade tensions cast a shadow over the global economic outlook, with possible negative implications on global growth and inflation—and subsequently potentially property values.
- Country impacts will vary depending on U.S. goods trade exposures, economic growth/sentiment and inflation impacts.
- Europe's advantage is that outside the U.S., its trading terms remain unchanged, supporting price stability.
- Increased growth risks mean further ECB interest rate cuts look likely.

PROPERTY MARKETS

- Despite the softening economic outlook, property valuations are well placed relative to equities and bonds.
- The commercial real estate sector remains at the foot of a new cycle, which is typically the best time to invest. Volatility will also extend this window.
- Building material cost uncertainty could further slow the development pipeline and intensify chronic modern space shortages, building the case for rental growth over the mid to longer term.
- Investing structurally, through aligning with long-term societal changes, should provide protection through the cycle.

Economic Outlook

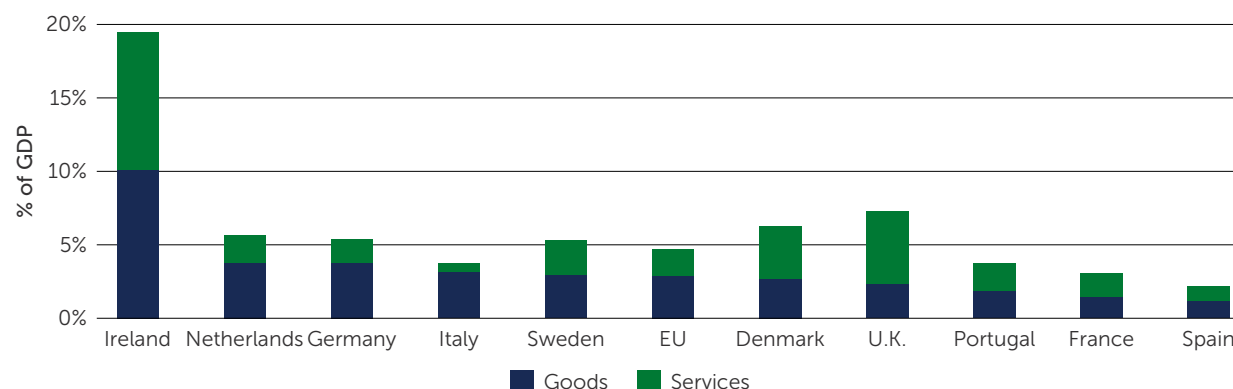
The second quarter has got off to a tumultuous start, with President Trump’s ‘liberation day’ announcement of widespread ‘reciprocal’ tariffs on U.S. imports, followed by a ‘surprise’ retreat days later, with an immediate 90-day pause on additional tariffs. At the time of writing, a worldwide universal 10% levy currently applies on most U.S. imports (with China the exception), alongside some individual sectoral tariffs.

While the turnaround was met with relief that a widespread trade war had been avoided (for now), the announcement has done little to quell uncertainty. Heightened tension between the world’s two largest economies—the U.S. and China—as each delivers retaliatory tariff blows, has negative implications for global growth and inflation, and subsequently potentially property values.

For the Eurozone, the temporary tariff reduction from 20% to 10% will bring some relief, yet businesses investment and consumer spending are expected to be delayed until there is greater clarity. The impact on European property values will depend on the degree of negotiated trade concessions and the wider impact on overall economic sentiment/growth. Unlike the U.S., Europe’s advantage is that its terms of trade with the rest of the world are unaltered (a trade substitution effect can part shield from the full brunt). Increased growth risks resulting from rising trade tensions mean that the European Central Bank (ECB) is expected to continue its interest rate cutting cycle.

Widespread global uncertainty has softened the Eurozone’s near-term growth outlook. From 2026 and beyond, the economy should hopefully get a boost from Germany’s looser fiscal debt rules and increased defence and infrastructure spending budgets. At the country level, tariff impacts will partially depend on U.S. trade exposure—the lower the exposure (i.e., Spain, France), the lesser the anticipated impact (**Figure 1**).

Figure 1: Tariff Impact Risks—Exports to U.S.



Source: Caixa Bank; Eurostat. As of December 31, 2024.

Capital Markets

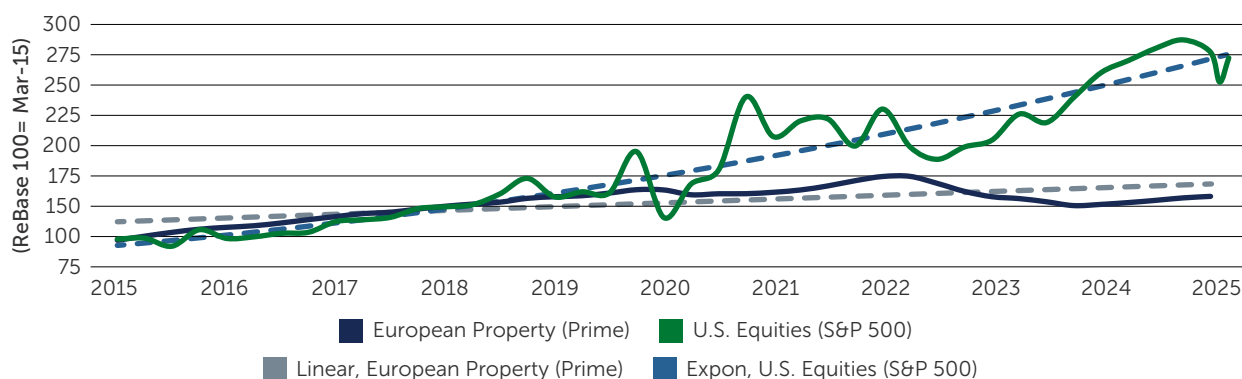
Preliminary data from Savills reports that European Q1 2025 investment volumes were above €50 billion, a 28% increase on Q1 2024. While the increasing momentum is welcome, investment volumes are still 45% under the previous five-year average. Recent geopolitical and trade developments will have dampening effect on investor demand. For Europe, there is scope for some of this negative sentiment to be offset by investors seeking relative stability and policy certainty. On balance, while the recovery will slow, the opportunity window to acquire top quality assets at favorable prices near the foot of the cycle has now been extended.

Commercial property values have appreciated by a robust 41% in Europe over the past 10 years, but that compares to over 170% for U.S. equities (S&P 500).¹ While equity markets declined roughly 15% since the peak, a very significant relative value gap still exists. Real estate pricing is heavily subdued following the sector's correction when interest rates increased during the post-pandemic inflation surge and the subsequent central bank hiking cycles. This provides an opportunity to invest at a lower valuation and basis as the market recovers.

Prime European total returns have started 2025 from a position of strength, recorded at 10.9% p.a., with the strongest performances recorded in high street retail (12.8% p.a.), followed by office (10.3% p.a.) and industrial (9.7% p.a.) in the year to March 2025.² The stability (and in some cases compression) of property yields, combined with strong rental growth is boosting prime total returns.

Reflecting the volatility in base rates, margins on European real estate lending were flat over Q1 2025, except for office assets which saw 10 basis points (bps) of margin compression.³ This reflects a building comfort from lenders toward the office sector. Competition has increased for lenders as the amount of capital deployed last year was less than intended; in particular, the value-add sector is most attractive as debt is accretive given the greater yield.

Figure 2: European Real Estate vs. U.S. Equities



Source: C&W; Barings Real Estate; Dow Jones. As of April 8, 2025.

1. Source: Dow Jones. As of April 8, 2025.
2. Source: Cushman & Wakefield. As of March 31, 2025.
3. Source: Chatham Financial. As of March 31, 2025.

Occupier Markets

OFFICE SECTOR

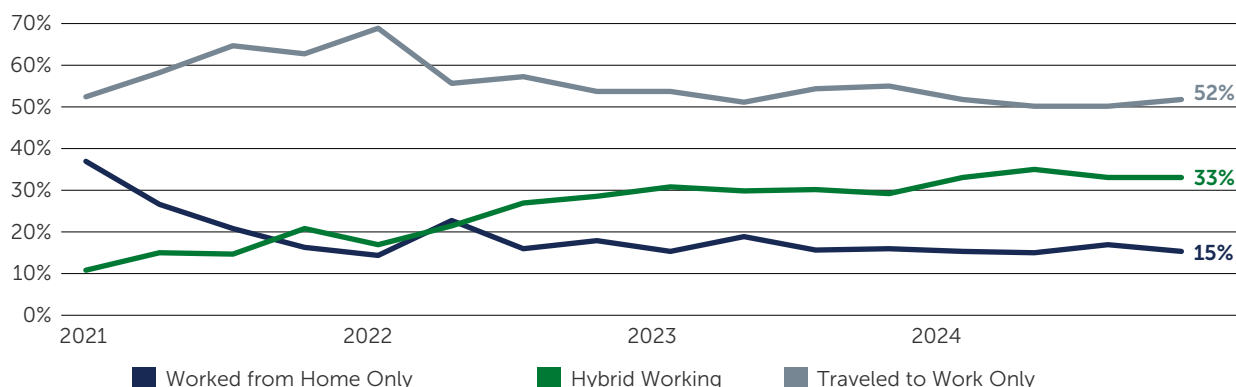
Compared to pre-pandemic levels, European office demand remains subdued. Take-up in 2024 totaled 10 million sq m, a slight improvement on 2023 (up almost 5%), but still more than 12% down on the pre-2020 long run average.⁴ The European office vacancy rate rose in Q4 2024 to 9.1%, up from 8.3% a year earlier.⁵ The largest increases were seen in Stockholm and a number of German cities, while Italy and Spain saw vacancy tighten over the last 12 months and London remaining flat.

Completions were manageable over 2024 at 1.6% of total stock, but 2025 completions will be higher at 2.1%, before easing to just above 1.0% in 2026 and 2027.⁶ Higher completions in 2025 and a cautious approach from occupiers in the wake of tariff uncertainty could see some softness in occupier markets in the months ahead. However, the development pipeline is likely to thin out given the softer economic outlook and rising uncertainty about construction costs.

Working from home trends, and its implications on the office sector, have been closely watched since the pandemic began over five years ago. U.K. data suggests that working from home, particularly on a hybrid basis, has become an embedded feature of the workforce. Economic softness notwithstanding, during this time occupiers have required ever higher quality space, embracing ESG factors. Intensifying shortages of top-quality prime space means these office assets have been outperforming.

This explains why, despite softer economic readings and subdued levels of leasing activity, European prime rental growth continued at 4.5% p.a. in 2024.⁷ This underlines the importance of stock selection and tapping into structural trends (demographic, technology, and ESG), to mitigate in periods of cyclical softness.

Figure 3: Percentage of Working Adults by Working Arrangement



Source: ONS. As of November 2024.

4. Source: Cushman & Wakefield. As of December 31, 2024.
 5. Source: Cushman & Wakefield. As of December 31, 2024.
 6. Source: Cushman & Wakefield. As of December 31, 2024.
 7. Source: ONS. As of November 30, 2024.

Occupier Markets

RETAIL SECTOR

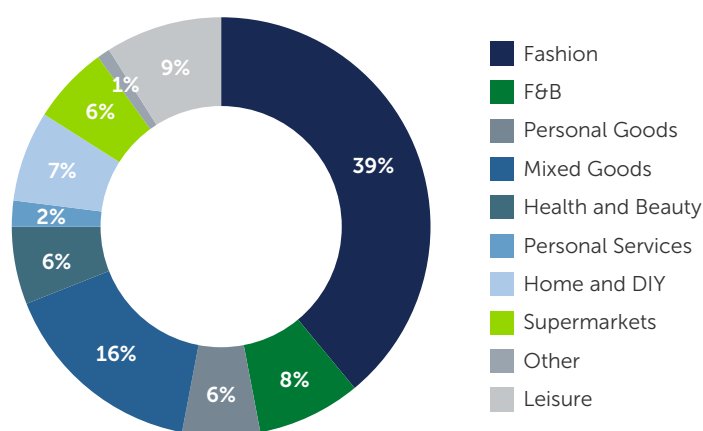
Negative global news flow means consumer confidence in Europe fell in April 2025 to -16.7 compared to -14.5 in March 2025.⁸ This is the lowest level since November 2023 but well above the depths of the cost-of-living crisis (-28.7 in September 2022). Confidence has struggled to reach its pre-pandemic norms or the post lockdown levels seen in 2021. It will likely continue to contract from here.

Retail sales in the Eurozone grew in February by 0.3% month-over-month, and by 2.2% p.a. over the last 12 months, while in the U.K. sales grew 0.8% month-over-month and by 2.2% p.a. over the last 12 months.⁹ Retail sales growth remains vulnerable to the further sentiment deterioration noted above, and a declining 'wealth effect' from falling equity markets.

In terms of leasing demand, despite apparel being a major e-commerce category, fashion remains the largest segment by sq m in 2025, accounting for almost 40% of European retail leasing volume in 2025 (**Figure 4**). The leisure category recorded significant growth in 2024, with a 15% increase in deals and 20% increase in the amount of floorspace leased over the last 12 months. While leisure should be somewhat resilient to e-commerce, it is still sensitive to broad inflation and economic pressures like other retail categories.

Recent European prime retail rental growth performance has defied the sector's long-term negative perceptions, outperforming over the last 12 months, expanding by 6.2% p.a. (0.9% quarter-over-quarter).¹⁰ This rate of growth outpaced the more structurally sound sectors, with industrial growth at 3.2% p.a., and residential rents stabilizing rapidly. The retail outperformance is likely a passing cyclical quirk (high inflation leading to lower effort/occupancy cost ratios), with cost of living pressures easing and economic sentiment and thus growth projections downgraded for 2025.

Figure 4: Europe: Leasing Volume (Sq M), by Sector



Source: Cushman & Wakefield. As of April 2025.

8. Source: Eurostat. As of April 30, 2025.

9. Source: Eurostat. As of February 28, 2025.

10. Source: Cushman & Wakefield. As of December 31, 2025.

Occupier Markets

INDUSTRIAL SECTOR

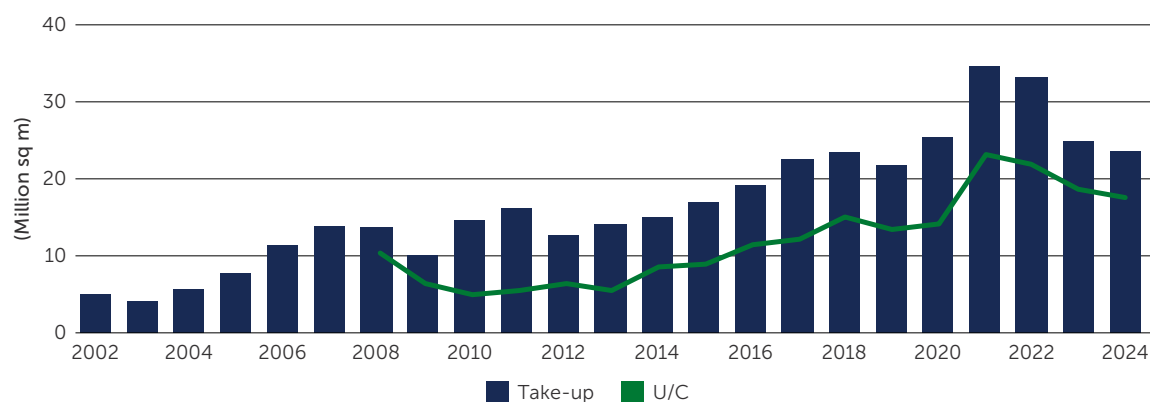
Following record demand in 2021/2022, industrial market conditions are normalising. JLL reported 2024 take-up at 23.7 million sq m, slightly down on the 2023 levels, but up 13% on the pre-pandemic average.¹¹ Third-party logistics operators (3PLs) remained the main demand driver, accounting for around 40% of total deals—slightly down on the 2023 level—while manufacturing and omnichannel retailer lettings rose slightly to 22% and 21%, respectively.

The average European logistics vacancy rate increased from just over 4% at the end of 2023 to just over 5% a year later, but still well down on the post-GFC era when it peaked at 15% in 2009. The vacancy rate for modern space is much tighter, with many core markets undersupplied in high quality, sustainable space.

Following eight consecutive quarters of falling construction volumes, development activity picked up in the final quarter of 2024.¹² With only roughly a third of the 17.6 million sq m under construction speculative, new supply is unlikely to satisfy rising occupier demand for high quality, sustainable space. New starts will probably ease given uncertainty around demand and build costs.

The pace of logistics rental growth continues to moderate, with rents rising 3.2% p.a. in Q1 2025, down from a peak of 17.3% p.a. in Q4 2022.¹³ Near term, softer economic growth will likely slow rental growth performance. Over the mid to longer term, the combination of supply shortages, alongside strong structural support (i.e., e-commerce expansion and near-shoring) builds a compelling case for rental growth. The sector may also benefit from uncertainty and a less global world—if larger stock inventories need storing closer to home markets.

Figure 5: European Logistics Take-Up vs. Space Under Construction



Source: JLL. As of December 31, 2024.

11. Source: JLL—European Industrial Market Dynamics. As of December 31, 2024.

12. Source: JLL. As of December 31, 2024.

13. Source: Cushman & Wakefield. As of March 31, 2025.

Occupier Markets

RESIDENTIAL SECTOR

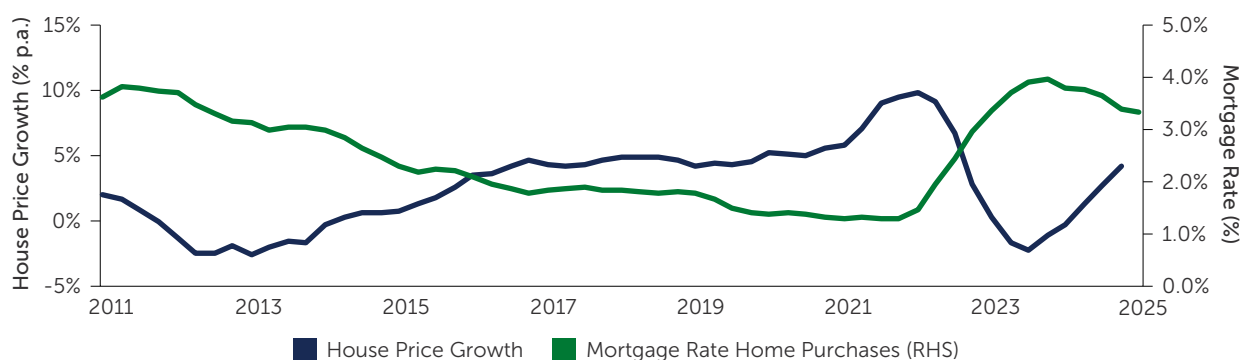
Eurozone house prices increased 4.2% p.a. in December 2024, taking prices to a record high.¹⁴ Individual country performance varied, with double digit growth in Spain (11.4% p.a.) and the Netherlands (10.8% p.a.), Italy close to the average (4.5% p.a.), and more modest growth in Sweden (2.4% p.a.) and Germany (1.9% p.a.). France was the outlier, with house prices still falling (-1.9% p.a.).

The combination of tight labor market conditions, falling inflation, real wage growth, and easing borrowing costs, increased transaction volumes and sustained price rises in 2024. The introduction of U.S. tariffs now raises uncertainty around the economic growth and interest rate outlook. Until there is greater clarity, activity levels may soften, as would-be buyers temporarily place plans on hold—a purchase is the largest investment most households will make—and that will ease upward pressure on house prices.

The long-term thesis to invest in European housing remains unaltered. Since the 2007 peak, housing completion levels have fallen sharply. To put this into perspective, over the past 15 years (to 2023) Eurozone housing completions averaged roughly 118,000 p.a., compared to 189,000 p.a. in the preceding 15 years.¹⁵ A strong development rebound is unlikely, given current uncertainty around tariff impacts on build cost inflation and thus new development viability. That means widespread chronic housing shortages will persist for the foreseeable.

In the Eurozone rental market, rents increased 2.9% p.a. in March 2025, almost double the long-run average growth pace (1.5% p.a.).¹⁶ Part of this growth is inflation driven, with many Eurozone countries having some form of rental indexation. Record house prices (noted above), higher borrowing costs compared to the recent past, and the need for a hefty first-time-buyer deposit, will continue to sustain rental demand, with the best growth prospects residing in Europe's most supply constrained, lightly regulated markets.

Figure 6: House Price Growth vs. Mortgage Rate



Sources: Eurostat. As of Q4 2024. ECB. As of February 2025.

14. Source: Eurostat. As of December 31, 2024.

15. Source: ECB. As of April 2025.

16. Source: Eurostat. As of March 2025.

About the Team

Barings Real Estate's research team has a diverse background covering various industries, asset classes and countries, which is complemented by an analytics function enhancing the team's ability to collect, augment and analyze data to inform better decision making.



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