

European Real Estate: So, We Survived ‘til 25?

Global geopolitical uncertainty has postponed the hoped-for European real estate recovery this year. However, while macro risk is high, property market risk is actually low—and the pause in recovery arguably extends the opportunity to invest near the start of a new property cycle.

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Executive Summary

ECONOMY

- Eurozone economic momentum remains elusive, with growth struggling to reach 1% per annum.
- Export surplus generating economies are potentially more impacted by global trade tensions, than those that are service sector and more domestically focused.
- While energy prices have ticked up of late, two more ECB rate cuts are expected in 2025.

PROPERTY MARKETS

- Speculation that real estate investment capital may be diverted from the U.S. is highly anecdotal and isn't evident in data like USD/EUR exchange rates in a meaningful way to date.
- In an increasingly volatile world, the local nature of property income and its relative stability may be set to become increasingly attractive.
- A tight supply of modern buildings will intensify, as new development remains constrained by high development finance and construction costs.
- Prime best-in-class real estate should continue to offer real inflation adjusted rental growth, despite a tepid European economy.

Economic Outlook

The Eurozone Composite PMI increased to 51.0 in July, from 50.6 in June, and both manufacturing and services improved.¹ The Services PMI is above the 50 + growth threshold at 51.2, while manufacturing marginally below at 49.8. Eurozone industrial production also jumped 1.7% month over month in May²—driven primarily by front-loaded stockpiling of Irish-produced pharmaceuticals in response to U.S. tariff threats—with a more subdued picture elsewhere.

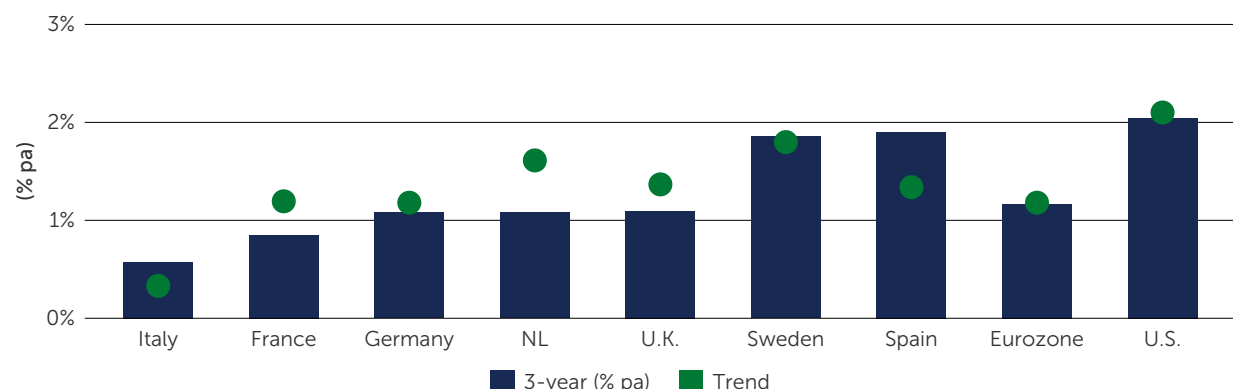
Trade tensions and other geopolitical events mean elevated uncertainty and pressures on the global economy. Export orientated economies face the greatest potential headwinds (e.g. Sweden and Germany), while those with more diverse service sector could prove more resilient (e.g. U.K. and Spain).

Oxford Economics retain their Eurozone GDP growth forecast of 1% per annum in 2025 and 0.8% per annum during 2026. Over the next few years, Spain is expected to remain the economic standout (1.9% pa), outperforming their own historic trend (1.25% per annum) and the Eurozone average (1.2% per annum) (**Figure 1**). Spain is benefiting from increased South and Latin American immigration, is more insulated from potential global trade wars, has strong tourism numbers, a robust labour market and is experiencing rising consumer confidence and spending.

Headline inflation was 2% per annum in June, a modest increase due to energy price base effects, and the core inflation rate notched up to 2.4% per annum³. Inflation is expected to remain close to target over the next few years. Germany's fiscal stimulus (defence spending etc) is helping offset possible negative demand impacts from trade tensions and other associated supply side price pressures.

The European Central Bank (ECB) trimmed another 25bps from interest rates in June, reducing the deposit facility rate to 2%. Two more ECB cuts are expected later this year⁴.

Figure 1: Economic Activity: GDP (3-year: 2025–2027)



Source: Oxford Economics. As of July, 21 2025.

1. Source: S&P Global. As of July 2025.
2. Source: Eurostat. As of July 2025.
3. Source: Eurostat. As of July 2025.
4. Source: Oxford Economics. As of July 2025.

Capital Markets

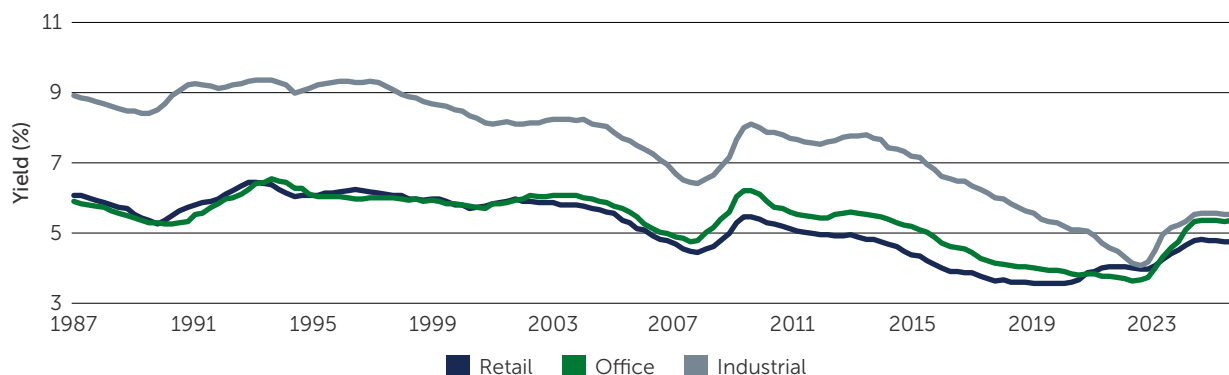
External market risks are elevated, with rising global geopolitical uncertainty driven by escalating Middle East tensions and a volatile U.S. administration. In Q1 2025, transaction activity fell compared to early 2024, with a slowdown among U.S. investors who had been particularly active last year, according to RCA/MSCI. Prime property yields also remained broadly stable at 5.2%⁵ having hovered around this level for over 18 months.

Property investors are currently speculating that capital flows previously destined for the U.S. market may now seek other destinations, and that Euro denominated assets could attain “safe haven” status. However, a systemic shift hasn’t been evident in wider capital market data since “Liberation Day”—i.e. USD currency movements (-10%) or Treasury yields (+ 40 bps)⁶.

Despite numerous external uncertainties, property market risks are currently low—it is the beginning of a new property cycle. In an increasingly volatile world, the local nature of property income and its relative stability is attractive. Tight vacancy and modern stock shortages have ensured continued rental growth against a tepid economy. Supply shortages will intensify, with new construction limited by a lack of development finance, high build costs, and sticky land prices, that are fast to rise but notoriously slow to adjust downward. Prime, best-in-class real estate will continue to offer real, inflation beating rental growth, even in previously out of favor office and physical retail sectors. Positive tailwinds for renewed investor demand across a wider opportunity set, beyond beds and sheds, looks set to build.

Economic uncertainty slows economic decision making, and the recovery in both property investment transactions and therefore debt deployment will lag. Activity remains weighted towards refinancings rather than fresh originations. In addition to swap rates easing back, European RE debt costs fell 5 bps to 25 bps in Q2 2025 depending on the sector and geography⁷.

Figure 2: European Prime Property Yields



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

5. Source: Cushman & Wakefield. As of June 30, 2025.

6. Source: Trading Economics. As of July 2025.

7. Source: Chatham Financial. As of June 30, 2025.

Occupier Markets

OFFICE SECTOR

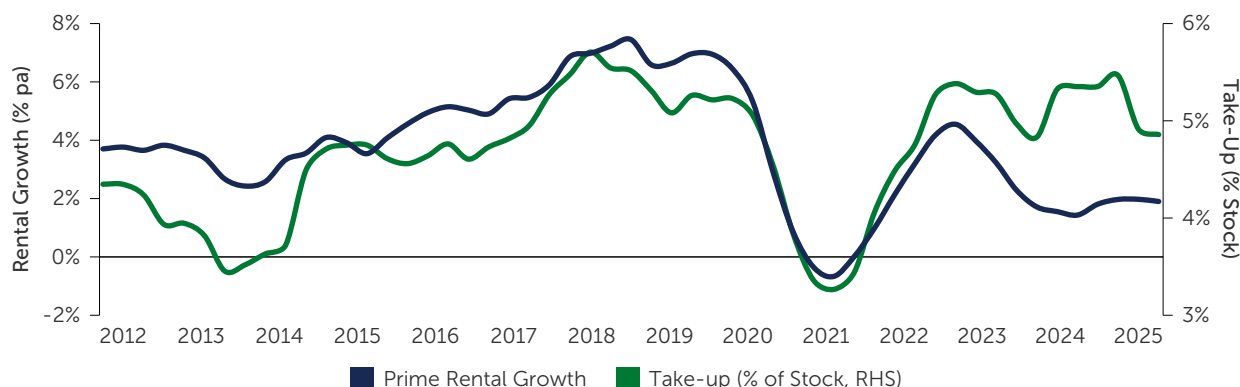
Savills' report 1.9 million sq m of take-up during Q1 2025, up 5% but still below the pre-pandemic average, and a similar improvement is expected this year. Prague, Dublin and the City of London are current demand hotspots, with lettings up 25-30% on the 5-year average. Encouragingly, even the lagging German office market is showing signs of a lettings pick up.

Vacancy was up +10 bps to 8.4% during Q1 2025⁸, typically significantly higher in peripheral locations, and much lower in core CBDs. Following a development surge, Dublin has the highest vacancy (17.5%) but is now stabilizing. Munich (7.5%) and Frankfurt (12.3%) saw sharper supply increases due to the release of second-hand surplus. In contrast, City of London (7.2%) and Copenhagen (6.6%) saw vacancy begin to tighten this quarter.

The combination of falling office values and rising costs explains office construction activity continuing to slow, down 20% over the past year to c.9 million sq m.⁹ That is a highly manageable 3.7% or sub 2% per annum addition to existing stock. New space under construction is most limited in Madrid and Stockholm (c.1%), higher in central London (6%) where a sustainability driven surge in stock renewal is currently on-going.

Prime headline office rental growth averaged 5.2% per annum¹⁰. With acute shortages of modern space set to intensify, new schemes letting up before completion, and a significant excess of occupier demand over the supply of sustainability buildings, we are highly confident that top rents will continue to ratchet upward - above the pace of inflation over the next few years. That will help a heavily out of favor property sector to re-establish a more stable, albeit reduced, position in investment portfolios and loan books.

Figure 3: European Offices: Rents and Occupier Demand



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

8. Source: Savills. As of May 2025.

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

10. Source: Cushman & Wakefield. As of June 30, 2025.

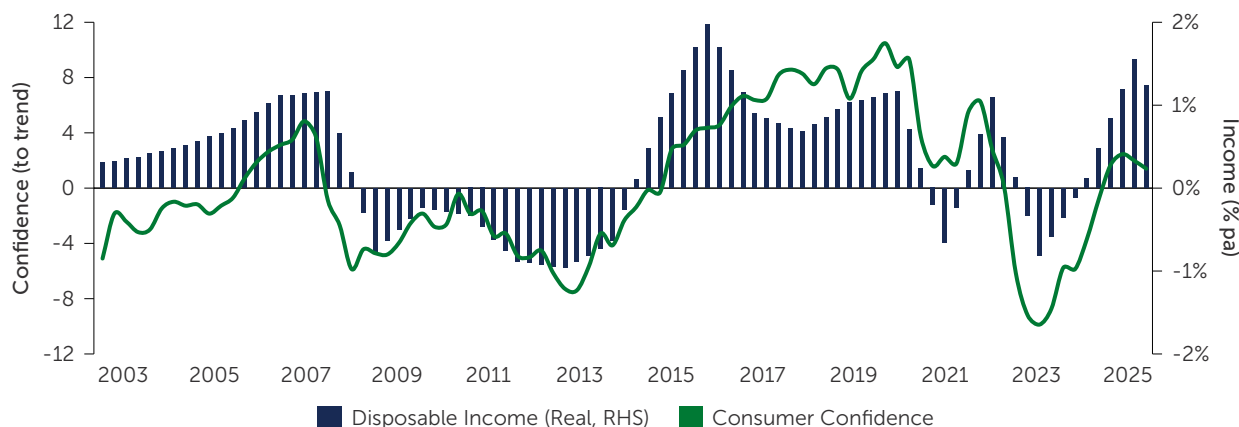
RETAIL SECTOR

European labor markets remain robust with unemployment still low at 6%, compared to a long-term average of 10%, but Eurozone PMI data indicates a softer job creation/hiring outlook. Consumer confidence, and ultimately households' propensity to spend has recovered from its 2022–2023 trough, but volatile global affairs mean overall sentiment is lower than the current healthy pace of real disposable income growth might normally suggest (**Figure 4**).

Household income outpacing consumption also explains why the saving rate continues to ratchet up, having increased from about 12% to over 15% over the past three years. If global news flow was to take a more positive turn, high savings would auger well for future purchasing power. Lackluster sentiment readings explain why Eurozone retail sales growth slowed sharply in May, down to 1.8% per annum from 2.7% per annum in April (or -0.7% month over month)¹¹.

While pockets of online resilience existed in top retail warehouse parks, grocery and the luxury segment, prime retail rents were beginning to slip before the pandemic years. By 2022/2023, the inflation surge had pushed up retailer's costs and stretched profits, but it also pumped up the volume of cash through the tills. Nominal retail sales values heavily outpaced real volumes and increased retail rent affordability, leading to lower "effort rates" (rents as a % of turnover). This form of inflationary pass best explains why prime retail rents continue to rise, currently up 6.2% per annum.¹²

Figure 4: The European Consumer Climate



Source: Oxford Economics; EuroStat. As of July 21, 2025.

11. Source: EuroStat. As of July 7, 2025.

12. Source: Cushman & Wakefield. As of June 30, 2025.

INDUSTRIAL SECTOR

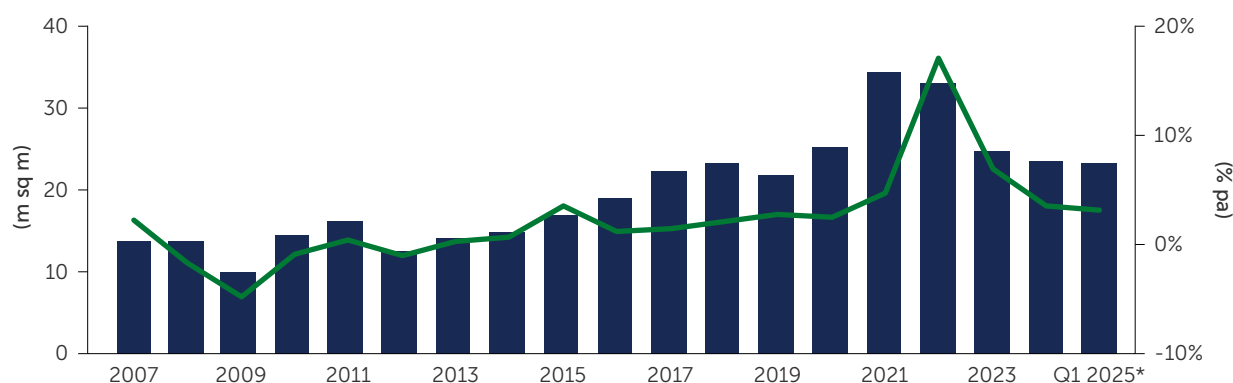
Uncertainty has seen logistics tenants remain cautious, delaying leasing decisions while possible shifts in global supply chains unfold. Yet letting demand remains resilient, with European take-up at 5.4 million sq m, flat on last year and close to pre-pandemic averages. Most markets saw increased letting activity in Q1 2025 but overall levels were similar to Q1 2024. However, Germany and Italy slowed (sub -15%) with a dearth of larger lettings noted. Occupiers continue to demand best-in-class ESG properties to achieve net-zero targets and operational efficiency. That largely explained a very large drop in the Netherlands of over 30%, driven by a lack of suitable modern energy efficient buildings.¹³

3PLs (third- party logistics providers) accounted for 40% of Q1 2025 lettings, partially driven by demand from Asian e-commerce and automotive companies expanding into Europe through 3PL networks. Manufacturing, grocery and physical retailers continue to prove resilient to headwinds, but e-retailers are making a comeback from last year's subdued levels. The European logistics vacancy rate edged higher to 5.4% this quarter from 5.1% at the end of 2024, close to the 10 year average.¹⁴

Space under construction currently totals 16.7 million sq m, this is down 5% per annum and is less than 0.5% of total stock. Speculative construction activity remains focused on Italy, the U.K., and the Netherlands at over 50% of construction activity. Build-to-suit activity is likely to become the preferred procurement route, given heightened developer cautiousness and other uncertainties.¹⁵

Prime rental growth stands at a robust 4.9% per annum through Q2, albeit prime rental jumped in France and Belgium. Some more generously supplied CEE markets are seeing single-digit rental declines occurring. Softer demand meeting gently rising supply suggests tenant incentives are increasing in markets where higher vacancy is prevalent.¹⁶

Figure 5: European Industrial Take-Up vs. Rental Growth



Source: JLL. As of March 31, 2025. *Annualized

13. Source: JLL. As of March 31, 2025.

14. Source: JLL. As of March 31, 2025.

15. Source: JLL. As of March 31, 2025.

16. Source: Cushman & Wakefield. As of June 30, 2025.

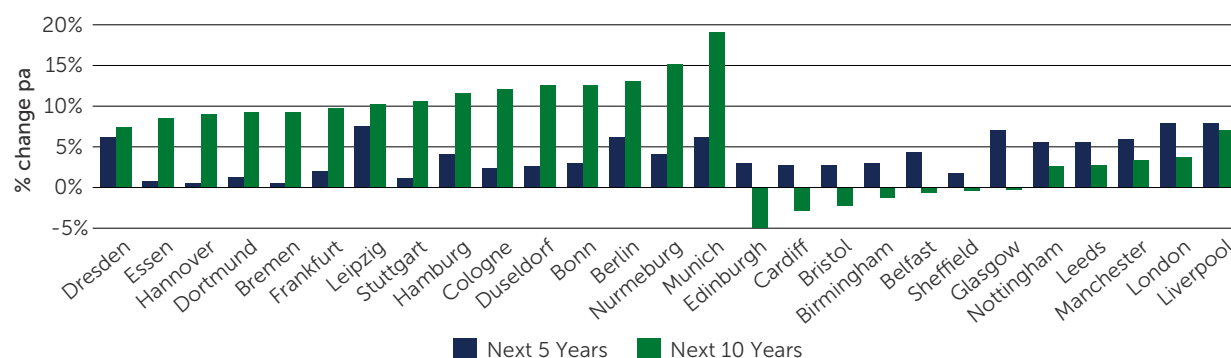
STUDENT LIVING SPOTLIGHT

The attractions of investing into purpose-built student accommodation (PBSA) are considerable. PBSA is currently a rapidly expanding institutional asset class across Europe, with a proven long-term U.K. investment track record. Positive diversification benefits are also highly likely, due to the semi-counter cyclical demand profile—i.e. student numbers often rising in economic downswings. While developer activity is increasing across mainland Europe, existing provision is chronically low. We expect long-term superior PBSA asset outperformance in locations with top-ranked universities, who attract affluent domestic and overseas students, and where the provision of modern student housing stock is lowest (e.g., Germany, Italy). Yet even in the more mature U.K. market, a lot of first generation PBSA stock is now approaching 25 years old and needs renewal. Moreover, a British education remains a huge draw for overseas students.

European demographic projections show that the domestic undergraduate student age population cohort (15–19 years) is set to grow most strongly across German and U.K. cities in the next 5 to 10 years (a typical institutional real estate holding period) (**Figure 6**). In addition to this organic/domestic growth, European universities, especially German ones, increasingly teach their syllabuses in the English language, more appealing to many international students. International student numbers are up over 15% in the last 5 years, with 2024 seeing a strong increase, suggesting no let-up.¹⁷ A more volatile global political backdrop around immigration and visa policies may ultimately favor the more liberal Eurozone bloc over other parts of the world.

European city centers are generally historic and therefore heavily protected, resulting in poor supply elasticity. These heavy development constraints apply to all types of housing, but especially new PBSA stock provision. A lack of new supply is expected to intensify, as starts are now declining. We anticipate ongoing upward rental pressures over the next few years where provision (beds to students) is most pronounced and subject to affordability and rent controls.

Figure 6: Domestic Student Age Cohort (15–19 Years)



Source: Oxford Economics. As of July 2025.

17. Source: Oxford Economics. As of July 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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