

European CRE: Macro Uncertainty Outweighs Strong Fundamentals

Europe has managed to weather various geopolitical storms this year, but the hoped for recovery in property investment has stalled. With property pricing also treading water, the opportunity to enter at the start of a new property cycle has been extended.

RESEARCH QUARTERLY



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Executive Summary

ECONOMY

- European growth prospects remain sluggish, escalating long term fiscal concerns.
- Uncertainty regarding U.S. policy is expected to continue to deter global trade and restrain investment activity.
- Inflation is back on track and another 2025 rate cut is possible.

PROPERTY MARKETS

- Elevated geopolitical risks have delayed the property investment recovery to 2026, despite strong fundamentals, attractive yields and improving lender sentiment.
- The uncertainty is masking a highly favorable market entry point for commercial real estate.
- Despite competition for capital deployment, European real estate debt markets remain mainly focused on refinancings due to low property transaction volumes.
- Notwithstanding the tepid economy, robust prime real rental growth is broad based and occurring across the four main property sub-sectors.

Economic Outlook

The Eurozone has managed to weather various geopolitical storms this year, but growth remains sluggish with GDP increasing by just 0.1% during Q2 2025¹ (0.6% increase Q1 2025). Monthly survey data remains similarly soft, but the Economic Sentiment Indicator (95.5)² and the Composite PMI (51.2)³ did creep up in September.

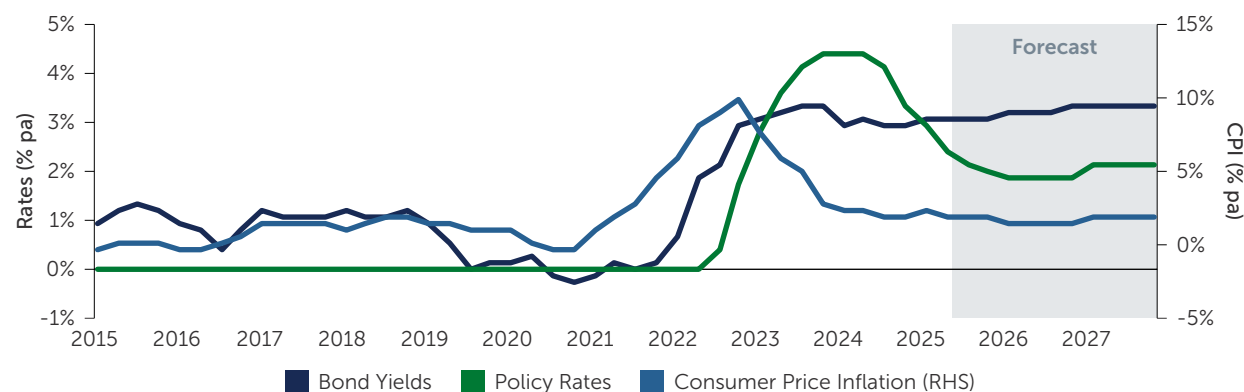
Oxford Economics forecasts Eurozone GDP growth of approximately 1% annually in both 2025 and 2026. The consumer is the primary pillar of support here, on the assumption that labor markets hold firm and household incomes keep growing more than the rate of inflation.

However, persistent geopolitical instability and uncertainty regarding U.S. policy are expected to deter trade and restrain investment activity. Therefore, improvements in both property investment transactions and lettings velocity will likely remain gradual during the next 12 months.

Separately, Eurozone CPI inflation edged just above the European Central Bank's (ECB) 2% target, at 2.2%⁴ in September. The increase was mainly due to energy effects that are expected to pass, with services and food remaining key areas under current ECB scrutiny. Eurozone monetary policy remained stable in September, currently at 2% for the deposit rate, but another cut, likely in December, is still on the table.

Additionally, potential divergence in policy rates and bond yields signal concerns over fiscal stability, with the global bond market focusing on the long-term path of French and U.K. GDP and thus public debt ratios. Nonetheless, current prime property yield spreads to risk free rates still look sufficient, particularly with prime rental growth picking up across all the four major property sub-sectors.

Figure 1: Eurozone Interest Rates & Inflation



Source: Oxford Economics. As of October 2025.

1. Source: Oxford Economics. As of October 2025.
2. Source: Eurostat. As of October 2025.
3. Source: SNP Global. As of October 2025.
4. Source: Eurostat. As of October 2025.

Capital Markets

The current geopolitical climate has heightened macro investment risks, with international fragmentation, conflict, fiscal concerns and an unpredictable U.S. administration all increasing uncertainty. As a result, the expected recovery in property investment for 2025 has been postponed.

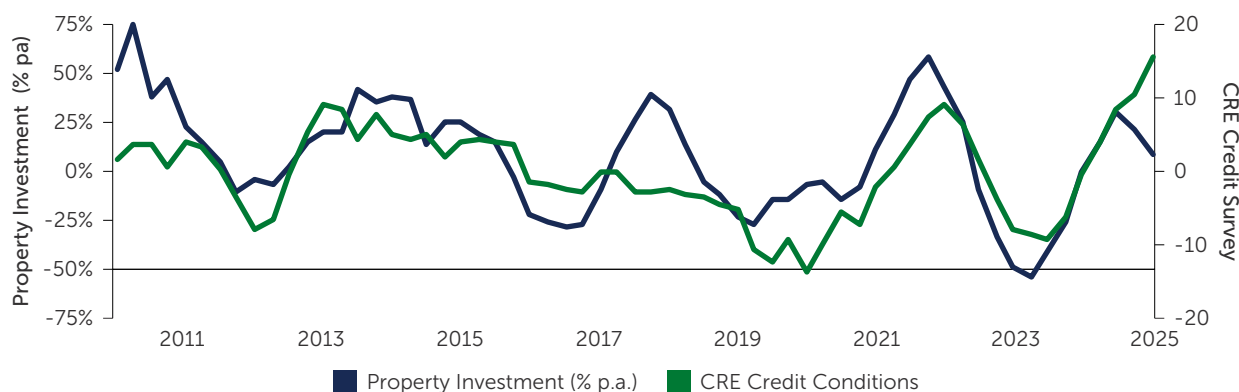
Although external risks remain elevated, we are at the beginning of a new real estate cycle, indicating that actual market risks may be lower than perceived. From a technical perspective, inflation is now in line with the ECB target, and prime property yields exceeding 5% present an attractive 200 basis point (bps) spread above risk-free rates⁵.

In addition, market fundamentals support recovery, with ongoing rental growth expected due to persistent shortages of modern space. Rising build costs and lower capital values will continue to squeeze project viability, while tighter Basel III regulations will further restrict bank lending for new developments. Taken together, these factors create a solid foundation for sustained prime rental growth beyond the usual 2–3 year development lag.

On the real estate debt side, Chatham Financial reports stable margins through Q3, at 150 bps for logistics, 200 bps for office, rising to nearly 250 bps for hotel and retail prime quality assets. Stabilization occurred in both debt pricing and real estate yields over the quarter. Despite strong competition for capital deployment, the market remains mainly focused on refinancings due to low property transaction volumes.

Ultimately, macroeconomic uncertainty continues to outweigh positive market fundamentals (rental growth) as well as favorable relative pricing and the current environment prolongs the opportunity to enter the market at an advantageous point in the commercial property cycle. Recent credit condition surveys conducted by the Bank of England (BoE) and the European Central Bank (ECB) indicate that improved lender sentiment towards real estate could contribute to a potential market recovery in 2026.

Figure 2: U.K. Property Investment and Credit Conditions



Sources: RCA/MSCI; Bank of England. As of October 2025.

5. Sources: Eurostat; & Cushman & Wakefield. As of Q2 2025.

Occupier Markets

OFFICE SECTOR

According to Cushman & Wakefield office take-up data, the pace of office lettings remains subdued, with annual CBD leasing activity across Europe showing minimal change at +2.5% for the year ending June 2025. Persistent macroeconomic uncertainties, ongoing evaluation of hybrid working arrangements, and rising fit-out expenses are resulting in an increasing number of corporations opting to renew existing leases rather than relocate to new premises.

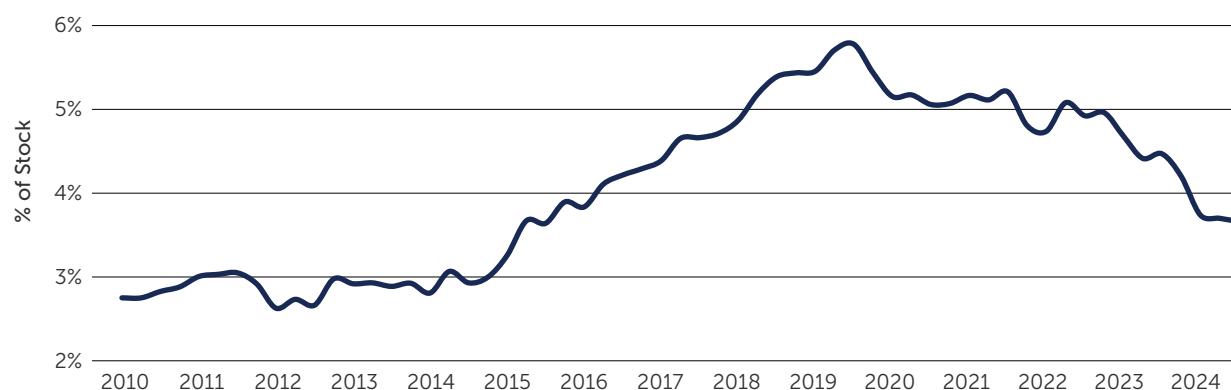
At a city level, markets that have experienced a higher demand recovery in the past year include Amsterdam, Dublin, Copenhagen, Frankfurt, London's West End, Manchester and Madrid (with increases of 25% to 40% per annum). In contrast, Vienna, Budapest, Oslo and Brussels still await recovery, while Paris CBD take-up has been negatively impacted by low availability levels⁶.

According to Savills, landlords are increasingly aiming to recover "green capex" by raising service charges. In some situations, these charges may be as high as 20% per annum, which could affect occupational affordability and have implications for rental growth from an investor's perspective.

On the supply side, Cushman's European office vacancy rate decreased to 9.3% in Q2 2025, remaining above the long-term average of approximately 8%. Supply decreased most in Amsterdam, Manchester, Madrid and Prague over the past year. In comparison, major German markets experienced an increase in available supply of between 15% to 30% during the same period.

Furthermore, Savills reports that prime office vacancy in the core European CBD office markets is significantly lower than overall vacancy, standing at just 3%. New office construction is down nearly 30% since mid-2022, and the supply of high-quality, low-emission buildings is set to tighten, supporting further prime rental growth which is currently running at a robust 5% per annum.

Figure 3: European Offices Under Construction



Sources: JLL; C&W. As of October 2025.

6. Source: Cushman & Wakefield. As of Q2 2025.

RETAIL SECTOR

Consumer confidence, a leading indicator for household expenditure, has held up despite events in the wider world. September's household sentiment print was -14.9⁷, slightly below the long-term average of approximately -11. Nonetheless, Eurozone retail sales continue to show growth, with real inflation-adjusted sales volumes increasing by 2.2%⁸ annually over the past year.

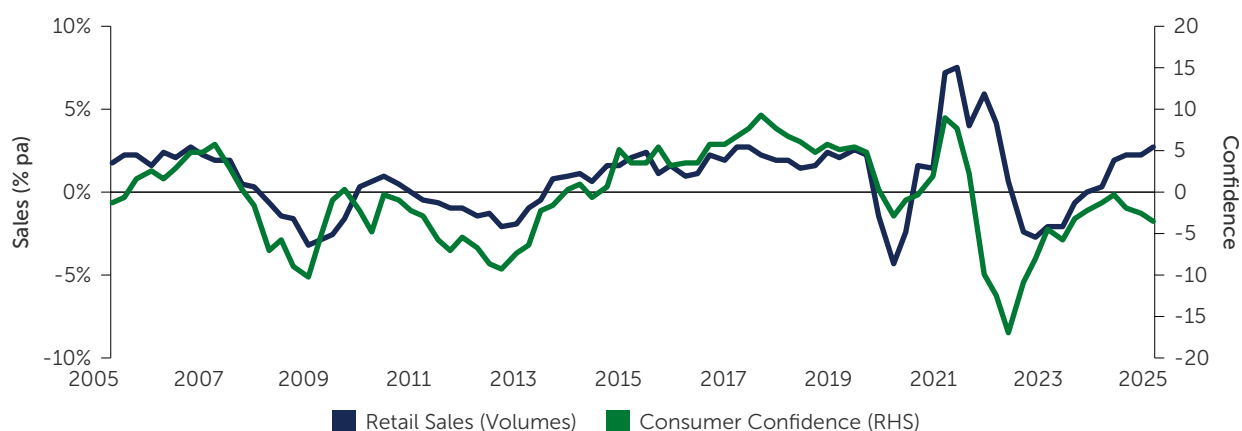
In addition, Eurozone wages are up 3.7%⁹ per annum in Q2 2025, outpacing CPI inflation at 2.2% per annum. We expect this real wage growth to help sustain retail sales and provide key support for the European economy given current multiple external headwinds.

According to CBRE, European retail footfall showed minimal change in the first half of 2025 compared to the previous year. Out-of-town retail parks recorded an increase of almost 5% during this period and are currently the only format performing better than pre-pandemic levels. Vacancy rates in CBRE managed retail parks are approximately half the overall sector average of 5.6%, which may be attributed to factors such as onsite parking and accessibility.

Prime rental growth is also increasing at 6% per annum through Q2 2025. This can be partially attributed to rising retail sales, but also the 10–15% rental decline during the pandemic years and subsequent 20% surge in nominal retail sales during the inflation shock of 2022/2023, positively shifting "effort rates" (rent to turnover) downward¹⁰.

Finally, although the cyclical outlook for retail has become more positive, ongoing challenges from e-commerce persist. Retail formats considered more resilient to e-commerce include grocery, neighborhood/convenience stores, non-electrical bulky goods, DIY/hardware and gardening supplies.

Figure 4: The European Consumer Climate



Sources: Oxford Economics; Eurostat. As of October 2025.

7. Source: Eurostat. As of September 2025.

8. Source: Eurostat. As of September 2025.

9. Source: Oxford Economics. As of Q2 2025.

10. Source: Green Street. As of January 2025.

INDUSTRIAL SECTOR

Due to global trade uncertainty, some logistics occupiers have paused expansion. JLL reports a 10% decrease in the first half of 2025 take-up compared to the first half of 2024, with demand focused on high-quality space and manufacturers. Notably, take-up increased in Hungary, Romania and Sweden while only Spain and the U.K. maintained steady demand in Western Europe.

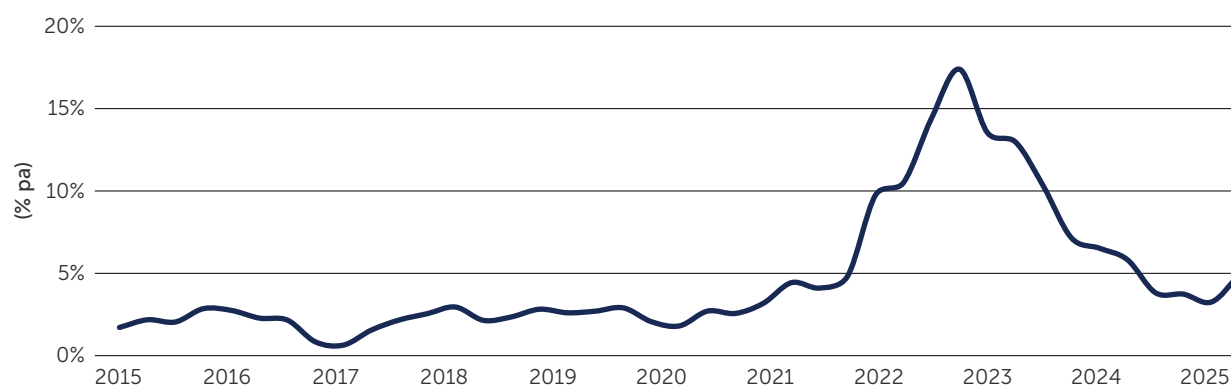
Leasing was concentrated in third-party logistics providers (3PLs) who were responsible for just under 40% of lease agreements in the second quarter, while retailers and e-retailers accounted for 27%¹¹. The demand for e-commerce space was predominantly driven by Chinese marketplaces. Manufacturer leases were primarily led by cost-effective countries such as Hungary, Italy and Spain.

Meanwhile, JLL's vacancy rate edged up in the second quarter reaching 5.9%, the highest level in almost five years. Secondary space rose as occupiers continue the flight-to-quality into completed speculative space.

At the same time, the increase in build costs and fall in capital values means development is rapidly slowing. CBRE reports that rolling 12-month completions declined to 15 million sq m, the lowest level since 2017. Likewise, JLL report that speculative space accounts for 40% of schemes under construction, the lowest level in four years.

Following a period of deceleration after elevated pandemic highs, industrial rental growth is trending back upward in 2025. According to Cushman's prime industrial rent data, there was a 2.5% increase over the second quarter, resulting in an annualised rate rising to nearly 5%, up from 3% the previous quarter—with Paris and Brussels growth hot spots.

Figure 5: European Industrial Rental Growth



Sources: Cushman & Wakefield; Barings. As of October 2025.

11. Source JLL. As of Q2 2025.

LIVING SECTOR

Supported by higher wages and lower mortgage rates, Eurozone house prices have grown about 4% per annum¹² in the past year. Buyer and seller expectations are now aligned more closely, helping speed up transactions. Importantly, mortgage demand—a lead indicator for price changes—remains in positive territory despite softening a little during Q3 2025¹³.

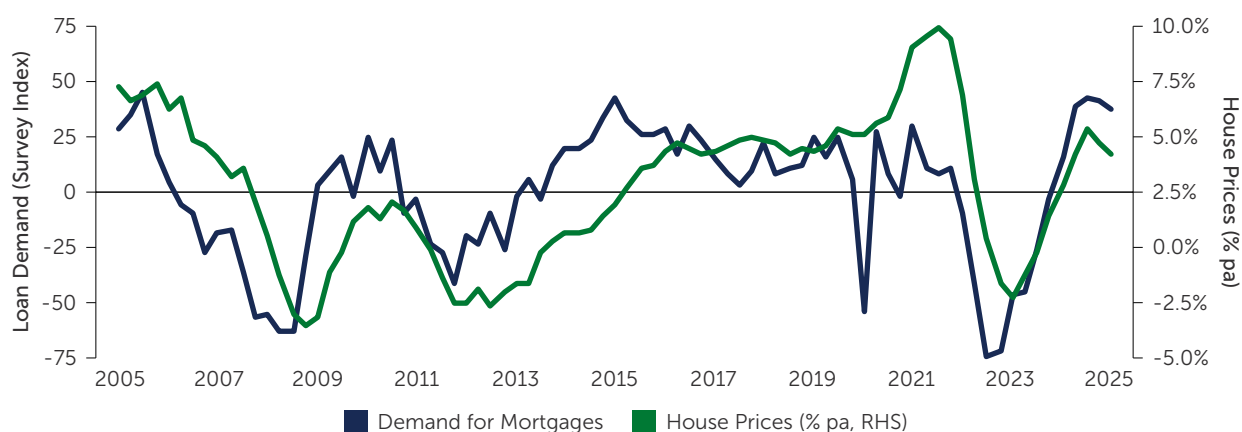
Across markets, Portugal had the strongest growth, with prices rising 17% per annum¹⁴, driven by “Golden Visas” and the lowest long term housing supply growth in Europe (sub 0.1% of stock per annum). Finland saw a -1.3% drop¹⁵, while U.K. prices rose 2% (Nationwide)¹⁶.

According to the ECB, average house purchase mortgage rates were 3.3% in Q3 2025, down from around 4% in late 2023, but up from 1.3% in 2021. Rate changes affect housing markets differently based on national mortgage market structures. For example: 70–100% of mortgages in the Nordics are variable or floating, so changes are felt immediately; while in Germany, the U.K. and France, where nearly 90% of mortgages are fixed rate, the impact is more gradual.

In terms of supply, European residential construction starts are decreasing due to economic constraints and a major new development wave is unlikely soon. A shortage of homes suggests continued rental growth in the mid-term.

At the policy level, rent control measures intended to cap rents and tie them to inflation or wage growth, remain a key investment risk for European residential investors. While these policies are intended to tackle affordability, they often limit investment, choke new housing supply and paradoxically increase underlying rental pressures. The public sector needs flexible approaches that balance rent regulation with incentives (grants/cheap land release etc) for developers.

Figure 6: The Eurozone Housing Market



Sources: ECB; Eurostat; Oxford Economics. As of October 2025.

12. Source: Eurostat. As of June 2025.

13. Source: ECB. As of September 2025.

14. Source: Eurostat. As of June 2025.

15. Source: Eurostat. As of June 2025.

16. Source: Nationwide. As of September 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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