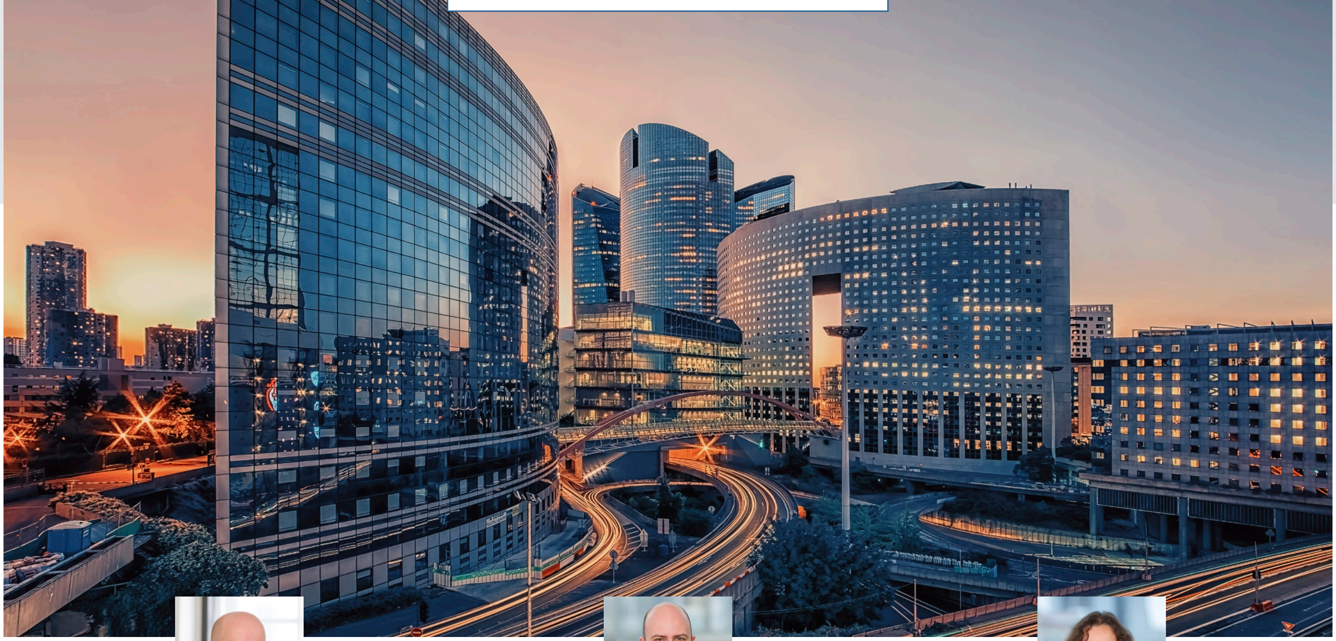
REAL ESTATE

European CRE: Despite a Firm Footing, the Recovery Stumbles…

Europe's CRE market recovery conditions are in place—a stable interest rate outlook, steady property pricing, improved financing access and positive rental growth prospects. Whether the market recovery gains traction in 2026 will depend on wider geopolitical and economic events.

RESEARCH QUARTERLY



Paul Stewart
Head of Real Estate Research & Strategy

Ben Thatcher
Associate Director, Real Estate Research

Jo Warren
Director, Real Estate Research

BARINGS

Executive Summary

ECONOMY

- A two-speed economy is emerging in Europe, with the Southern economies driving growth.
- Uncertainty has dented momentum in market sentiment.
- As inflation returns to target, interest rates are likely to stabilise for now.

PROPERTY MARKETS

- Underlying supports for the recovery in CRE transaction volumes are in place, subject to geopolitical risks.
- An undersupply of modern, high-quality assets will continue to drive mid to long term rental growth performance.
- The scope for yield compression is likely to be more limited in this property cycle than last.
- Strong lender competition will benefit borrowers and provide support for new acquisitions.

Economic Outlook

The Eurozone economy showed only a modest 0.3%[1] expansion in Q3 2025, but the headline growth belies varied growth trajectories across the continent. A two-speed recovery is emerging, with the southern European economies continuing to outperform, while Germany and Italy were stagnant.

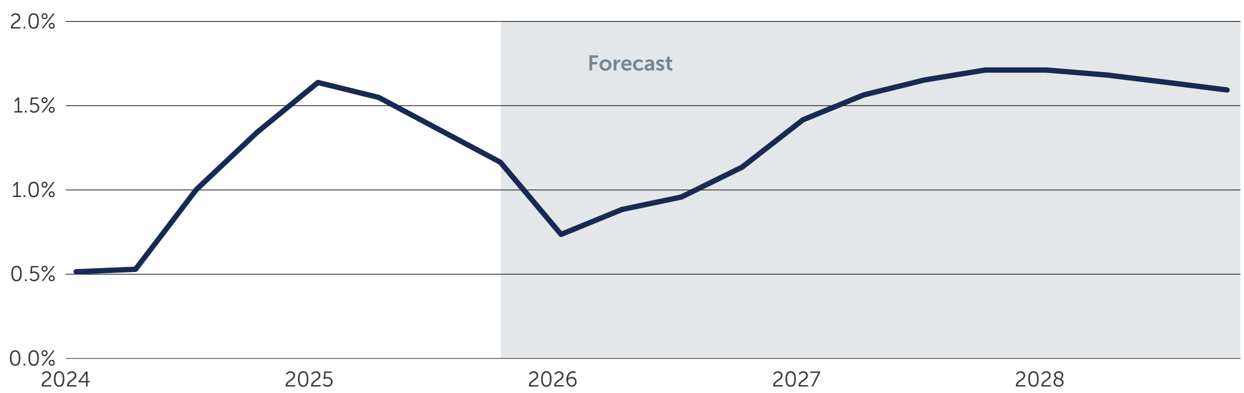
After six months of steady gains, momentum in business sentiment softened into year end. The Eurozone Composite PMI eased to 51.5 in December, down from November's 30 month high of 52.8, driven mainly by a pullback in services. The European Economic Sentiment Indicator slipped as well, edging down from 97.1 to 96.7, and remaining below the 100 threshold that typically signals sustained confidence.[2]

Eurozone CPI dipped to 2.0% in December, bringing headline inflation back to the ECB's target. Faster food inflation was offset by easing price pressures in services, industrial goods and energy. With inflation on target, the ECB held the main refinancing rate at 2.15% at its December meeting, helping anchor reduced interest rate expectations.

Yet long term borrowing costs have not followed policy rates lower. Government bond yields remain elevated, reflecting rising concerns about fiscal stability. Despite this, the yield environment remains broadly supportive for real estate with a transactable spread (akin to the pre-quantitative easing norm) and expanding rents. Should U.S. rates fall this year and European economic growth continue, this market and policy rate disconnect may also ease.

Eurozone GDP growth has been resilient with a 1.2% pa expansion despite the elevated uncertainty. Growth is expected to ease to 1.0% pa in 2026, before accelerating in 2027 to 1.7% pa, with the increase in German defence spending providing stimulus.[3] All of this assume relative geopolitical and U.S. policy stability.

Figure 1: Eurozone GDP Projections



Source: Oxford Economics. As of January 2025.

1. Source: Oxford Economics, as of January 2026.
2. Source: Eurostat. As of January 2026.
3. Source: Oxford Economics. As of January 2026.

Capital Markets

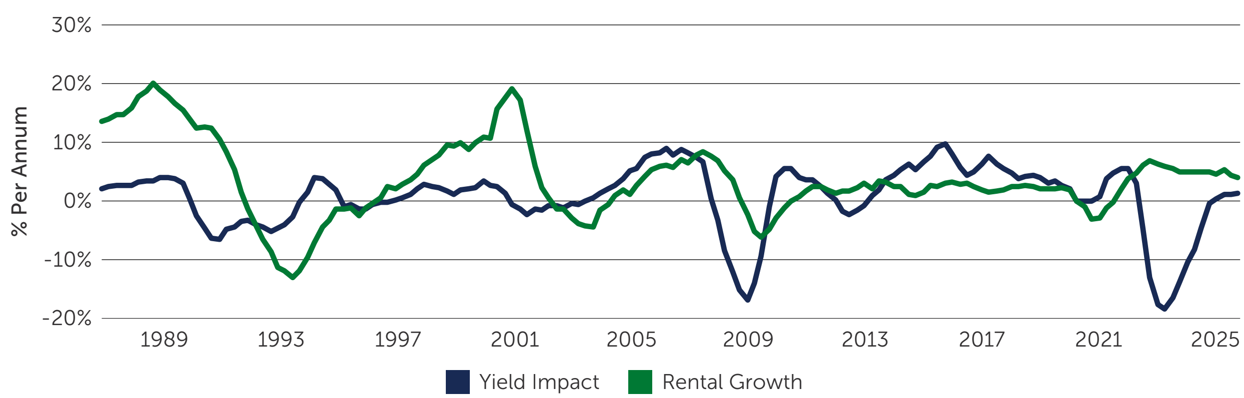
The recovery in European real estate investment transaction volumes failed to gain traction as heightened geopolitical and economic uncertainty weighed on the economy and investor sentiment. Transaction volumes held broadly steady, reaching €146.9 billion in the first nine months of 2025, little changed from the same period in 2024 (€146.3 billion).[4]

Property pricing remained broadly flat for the second consecutive year, with the All-Property prime yield at 5.1%[5] in Q4 2025. All-Property prime rents increased by a healthy 4.3% per annum through year end.[6] The undersupply of modern, high-quality assets continues to sustain rental growth, and with development activity levels already low and falling further, this should continue to drive performance over the mid to long term. A higher interest rate climate means the scope for yield compression is likely to be limited in this property cycle than last.

Lender sentiment also remained robust. According to Chatham Financial, activity was split evenly between acquisitions and refinancings, with margins broadly stable through the second half of 2025. Leverage stood at 55–60% for senior lenders and up to 70% for debt funds. Lender preferences have broadened, with sentiment around office, hotel and retail sectors improving. Overall, strong lender competition is favouring borrowers.

While there are no clear signs of an imminent uplift in property transaction activity, the underlying supports of robust real rental growth, a positive yield spread of 150–200 basis points (bps) for prime assets and much improved lender sentiment represent the normal requisites for rising investment activity. Whether that happens this year will depend, once again, on wider global geopolitical stability.

Figure 2: Prime Property Yield Impact vs. Rental Growth



Source: CBRE, C&W, Barings Research. As of Q4 2025.

4. Source: RCA. As of Q3 2025.
5. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q4 2025.
6. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q4 2025.

Occupier Markets

OFFICE SECTOR

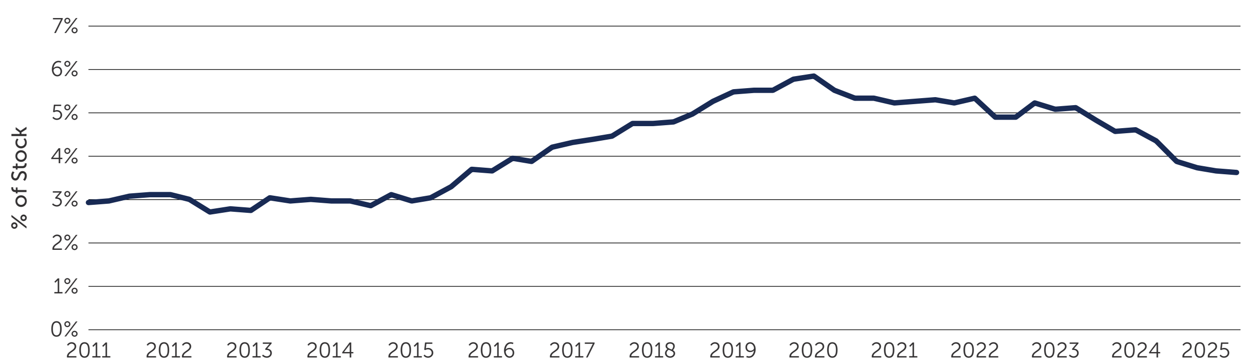
Office demand remains subdued across Europe, with annual take up to Q3 2025 totalling 9.0 million sq m, broadly flat (-1.5%) compared with the same period last year.[7] While strong increases in Frankfurt, Dublin and Amsterdam were observed, slower leasing momentum occurred in the gateway London and Paris markets. Vacancy reached 9.6% in Q3 2025—its highest level since 2014 but still below the previous cyclical peak of over 10% and modest in a global context.[8] The headline number reflects some delays to expansion plans, given this year's uncertainty, yet A-grade space remains drum tight. BNP Paribas Real Estate reports that the flight to quality continues, illustrated by CBD vacancy of 2.1% in Barcelona, 2.7% in Milan, and 3.5% in Munich.[9]

At the same time, Europe's office development pipeline is drying up, with just 3.8% of total European office stock under construction in Q3 2025.[10] Rising construction costs and lower office values have heavily stretched project viability, leading to reports of corporates struggling to find new accommodation and instead being forced to extend existing leases on outdated premises. As this trend continues, prime rents will likely steadily continue to ratchet upward, for at least the remainder of the decade.

With demand concentrated in prime space and new office development constrained by financing and cost pressures, repositioning and repurposing projects are gaining prominence. JLL research indicates retrofit can generate favorable premiums of 10–30%, while avoiding the higher risks of full redevelopment. Centrally located, amenity-rich areas are preferred, though many lie in historic districts that limit project scale and restrict the ability to expand supply.

Underlying demand for prime office space is evident in rental performance: despite economic volatility, prime rents have consistently grown by more than 4% p.a. since 2022. Rents increased by 4.6% per annum, well above the long-run average and, most importantly, the pace of inflation.[11]

Figure 3: European Offices Under Construction



Source: JLL, C&W. As of Q3 2025.

7. Source Cushman & Wakefield. As of Q3 2025.
8. Source Cushman & Wakefield. As of Q3 2025.
9. Source: BNP Paribas Real Estate. As of Q3 2025.
10. Source Cushman & Wakefield. As of Q3 2025.
11. Source Cushman & Wakefield. As of Q3 2025.

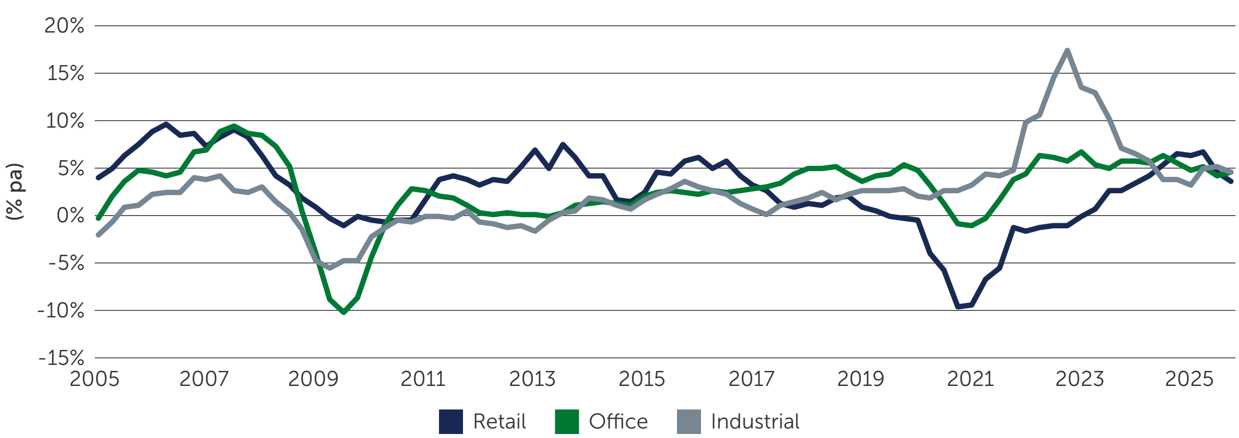
RETAIL SECTOR

Consumer sentiment remains subdued, with the Eurozone indicator easing to -13.1 in December, slightly below the long-term trend of -11.0. Nonetheless, retail sales displayed resilience, with Eurozone retail sales volumes increasing by 2.2% per annum in November.[12 13] Labour market conditions also remain stable[14], with the Eurozone unemployment rate at 6.3%—close to the series all-time low—and wage growth of 3.0% per annum[15] in Q3 2025 continuing to outpace inflation at 2.0%.[16] Although consumer caution may be encouraging saving over spending, supportive consumption tailwinds should come from the Eurozone's solid labour market and rising real wages.

In the retail leasing market, market size, consumer affluence and tourism spending remain the three key considerations, according to JLL. Omnichannel capability is increasingly important, with demand focussed on larger units that can deliver a positive customer experience and support instant fulfilment expectations. Europe's aging population and the expansion of the health and wellness sector could also generate opportunities for retail landlords and asset managers to diversify their tenant base. CBRE's analysis shows that shopping centres offering these services have benefitted from improved footfall.

Prime retail rental growth sharply slowed from 6.7% per annum in mid-2025 to 3.6% per annum in Q4 2025.[17] This squares with our contention that online retail will continue to weigh on non-grocery physical retail, and that the recent revival would prove temporary. The inflation surge has passed but has boosted in-store turnover and reduced 'effort rates' (rent as a percentage of nominal turnover). Looking ahead, rental growth projections from Capital Economics anticipate that Eurozone retail rental growth will average 2.3% per annum over the next three years, may prove optimistic.

Figure 4: European Prime Rental Growth



Source: CBRE, Cushman & Wakefield, Barings Research. As of Q4 2025.

12. Source: Eurostat. As of December 2025.
13. Source: Eurostat. As of November 2025.
14. Source: Eurostat. As of November 2025.
15. Source: Eurostat. As of Q3 2025.
16. Source: Eurostat. As of December 2025.
17. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q3 2025.

INDUSTRIAL SECTOR

JLL reports that European logistics leasing activity showed signs of renewed momentum in Q3 2025 despite ongoing geopolitical uncertainty. New space requirements are coming to market as occupiers reach a point where decisions on supply chains can no longer be deferred.

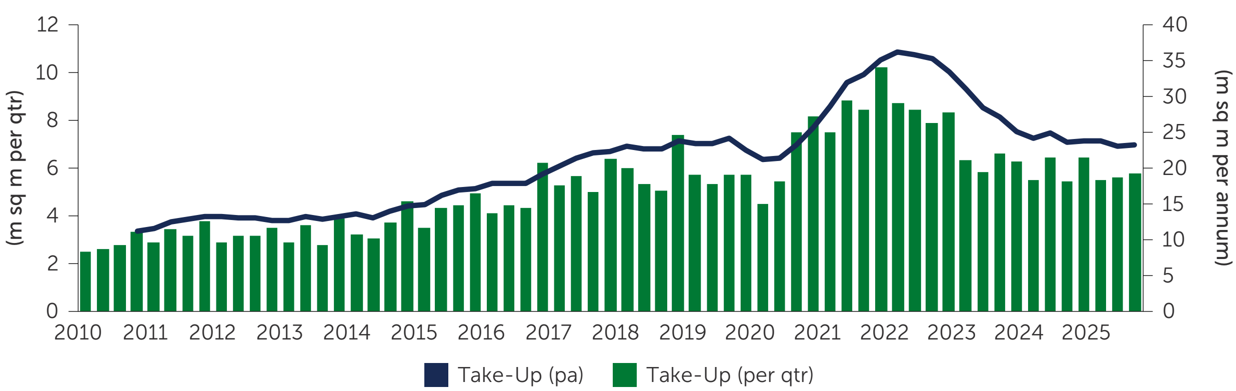
Logistics leasing activity strengthened, with take-up totaling 5.7 million sq m in Q3 2025, up 4% compared to Q2 2025.[18] Despite the quarterly improvement, total 9-month take-up to September 2025 was slightly down (-4%) compared to last year, though it remained almost 10% above the five-year pre-pandemic average. Leasing was limited by a lack of modern, ESG-compliant space in key markets. 3PLs drove demand, accounting for nearly 40% of take-up, while manufacturing contributed about 25% and was the only sector to avoid a year-on-year decline, supported by expanding renewables, new tech and defence firms expanding.[19]

JLL reports that vacancy increased again in Q3 2025 to 6.3%, the highest level since 2016, but much lower than previous cyclical peaks. This rise was predominantly weighted toward older space, reflecting occupier preferences for newer, modern stock. At the same time, completions have been moderating since 2023. CBRE reports the last 12 months delivered 16.7 million sq m, down more than 20% on the previous five-year average. Softer completions should intensify and provide support for the absorption of vacancy and sustain rental growth.

We still prefer logistics assets with high land value ratios, as they offer better obsolescence protection, greater supply inelasticity due to location scarcity, and better potential for sustainable income growth. Although both final mile and port logistics assets typically meet these criteria, we favour final mile assets for their lower long-term risk, given that global trade is typically more volatile, especially in the current climate, than online retail growth.

Prime industrial rental growth increased by 0.7% in Q4 2025, and by 4.6% year-on-year, with gains led by increases in Spain, Ireland, Germany and the U.K.[20]

Figure 5: European Industrial Take Up



Source: JLL. As of Q3 2025.

18. Source: JLL. As of Q3 2025
19. Source: JLL. As of Q3 2025
20. Source: Cushman & Wakefield. As of Q3 2025.

LIVING SECTOR

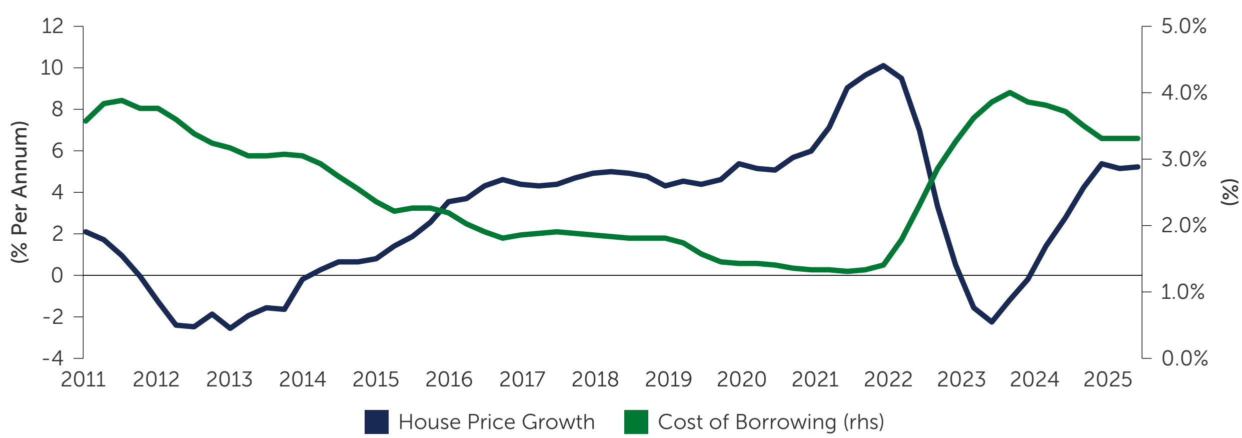
House price growth and borrowing costs are strongly negatively correlated, with the early 2024 easing in mortgage rates shortly followed by a return to positive house price growth. Eurozone house price growth remains strong, albeit there are tentative signs of levelling off, with prices increasing 5.1% per annum in Q3 2025, unchanged from the previous quarter.[21] There is wide country variation in growth rates, with Spain's strong economy helping drive double digit price increases (+12.9% per annum), while France's more challenging economic conditions are dragging on performance (+0.7% per annum).

The pace of Eurozone rental growth continues to outperform inflation (2.0% per annum in December), with rents rising by 2.9% per annum in Q4 2025; a level well above long-term trend of 1.6% per annum. The cyclical driver of residential rents is real, inflation adjusted wage growth, where the outlook is positive (see retail).[22 23]

The severe shortage of rental homes, limited new construction and poor buyer affordability are likely to sustain rental growth in the medium term. Only significant changes, such as a sharp rise in interest rates or unemployment (leading to falling house prices), or a major boost in house building, might reverse this trend. Even the introduction of rent controls, a brake in the short term, only tends to aggravate the rental supply side longer term.

In the student accommodation sector, tighter U.S. visa rules could boost European international student numbers, with Spain likely to benefit from cultural ties and the U.K. attracting interest for its prestigious institutions despite ongoing visa pressures. To increase appeal, other countries, such as Germany, are increasing their English taught courses. Higher global ranking universities that attract international students, as well as more affluent domestic students, should remain a primary investor focus, as they typically have greater capacity to meet the rental levels necessary for private PBSA scheme viability.

Figure 6: Eurozone House Price Growth vs. Mortgage Costs



Sources: OECD, ECB. As of Q3 2025.

21. Source: OECD. As of Q3 2025.
22. Source: Eurostat. As of December 2025.
23. Source: OECD. As of Q4 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.

Paul Stewart
Head of Real Estate Research & Strategy

Ben Thatcher
Associate Director, Real Estate Research

Jo Warren
Director, Real Estate Research

Barings is a $481+ billion global asset management firm that partners with institutional, insurance, and intermediary clients, and supports leading businesses with flexible financing solutions. The firm, a subsidiary of MassMutual, seeks to deliver excess returns by leveraging its global scale and capabilities across public and private markets in fixed income, real assets and capital solutions.*

LEARN MORE AT **BARINGS.COM**

**As of December 31, 2025*

26-5174777