REAL ESTATE

European CRE: Uncertainty Extends the Opportunity

Europe's property market recovery has been postponed, as the Middle East conflict brings a resurgence in inflation anxieties. However, any future ECB policy rate hikes are likely to be much more modest this time. Even so, the market remains resilient, with chronic shortages of modern space set to worsen as development activity continues to fall.

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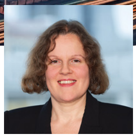

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Executive Summary

ECONOMY

- The conflict in Iran **adds uncertainty to the outlook**, with the ultimate impact determined by its **duration**.
- **Rising energy prices** nudged March inflation higher, with two rate rises now in play.
- The European Central Bank (ECB) faces the challenge of carefully **balancing slower growth and higher prices**.

PROPERTY MARKETS

- We do not expect significant value shifts, as the Commercial Real Estate (CRE) sector has not yet rebounded, **rents are increasing** and **yield spreads remain adequate**.
- Despite a clouded macro outlook, **CRE resilience exists in the form of modern stock shortages**, an easing development pipeline and expanding rents.
- Renewed uncertainty will likely moderate the pace of the transaction volumes recovery, but also extend the **opportunity to acquire at attractive pricing**.
- Current circumstances yet again reinforce **the importance of investing structurally**, and aligning with enduring trends such as demographics, technology and ESG, especially for those seeking inflation protection.

Economic Outlook

2025 ended with tariff disruptions fading and rising hopes for a return to relative normalcy. However, the **Middle East conflict has reintroduced uncertainty and pushed energy prices higher**. The breakout of the conflict clouds the outlook for GDP, inflation and, in turn, interest rates, prompting Oxford Economics to revise its projections.

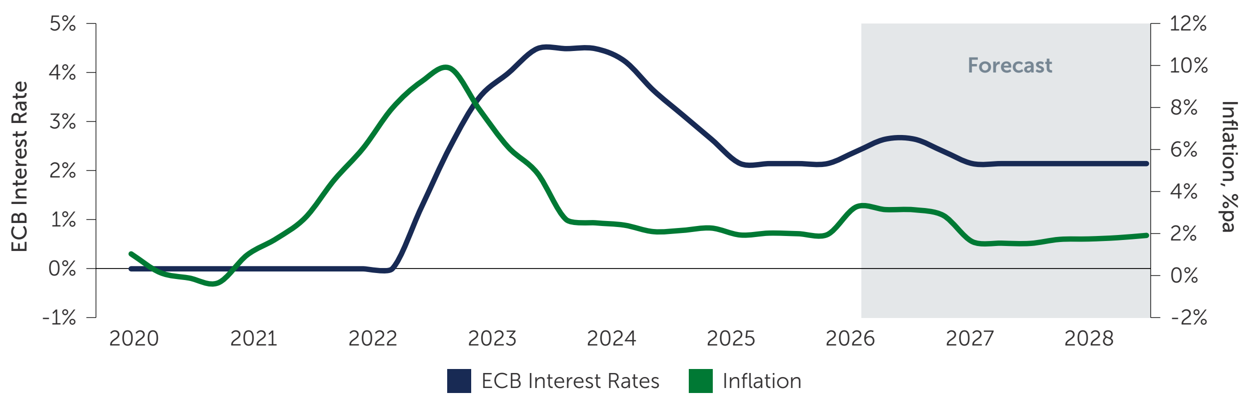
Survey data has begun to reflect Middle East tensions. The Eurozone composite PMI fell to 50.7 in March,[1] as **higher energy prices, market volatility and supply chain uncertainty weighed on activity**. Services weakened (down 1.7 points to 50.2), while an uptick in manufacturing (up 0.8 points to 51.6) is likely a lagged data point.[2]

Eurozone inflation spiked in March to 2.6%,[3] a level last seen in July 2024. Upward energy price adjustments (up 7% month-on-month) were the main driver of the increase. Oxford Economics expects inflation to average 3% this year (up from 1.7% previously), boosted by rising energy prices, with some potential spillover into food and core prices.

While inflation expectations are rising, **monetary policy is more restrictive than before the Ukraine war**. The ECB will have to carefully balance slower growth and higher prices. Oxford Economics has revised interest rate forecasts upward, but only by 50 basis points (bps), with the policy rate projected to reach 2.65% by year end before easing back to current levels.

GDP projections for the Eurozone have been lowered. Oxford Economics downgraded 2026 growth by 0.2 percentage points to 0.8% pa, and by 0.1 percentage points to 1.5% pa, reflecting pressure on real incomes but only a limited drag on investment. **However, the outlook remains highly uncertain and hinges on the intensity and duration of the energy shock**.

Figure 1: Eurozone Inflation and Interest Rates



Source: Oxford Economics. As of April 2026.

1. Source: S&P Global. As of April 2025.
2. Source: S&P Global. As of April 2025.
3. Source: Eurostat, As of April 2025.

Capital Markets

European CRE investment volumes held steady in 2025, reaching €224.9 billion,[4] despite heightened geopolitical uncertainty. The U.K. led activity, while Germany lagged, likely due to larger debt funding gaps.

The Middle Eastern conflict has driven a **sharp rise in energy prices**. The precise impact on inflation, interest rates and ultimately **property yields and capital flows is uncertain** and will largely depend on the conflict duration.

Global financial markets are anticipating that the ECB will hike rates. However, unlike the Ukraine invasion in 2022 when energy prices last soared, monetary policy is now more restrictive and consumer spending is weaker.

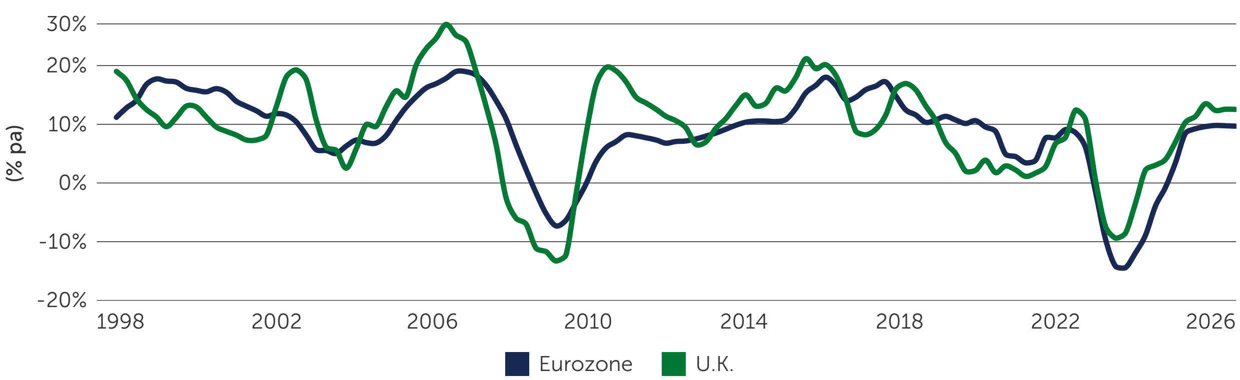
Investor survey responses indicate that **living is the most popular sector among European investors**, followed by industrial and logistics. Alternatives are also gaining appeal, with student housing most preferred, followed by retirement living and real estate debt.[5]

Real estate debt liquidity and lender appetite remain strong, with plenty of capital chasing limited deals. That said, geopolitics is shifting lender sentiment toward a more cautious stance.

Property debt margins were steady through the first quarter, with **pricing shifts mainly reflecting increases in underlying benchmark rates**. Five-year swaps rose to 2.5% for Euribor and 4% for U.K. SONIA,[6] levels that compare to prime European property yields of about 5%.[7]

We do not expect significant value shifts, as the **property sector hasn't rebounded, rents are increasing and yield spreads remain adequate**. Current circumstances extend the opportunity to acquire at favourable price, and yet again reinforce the importance of investing structurally, aligned with enduring trends such as **demographics, technology and ESG**, particularly where inflation protection is a key criterion.

Figure 2: European CRE Total Returns (Prime)



Sources: CBRE; Cushman & Wakefield, Barings Research. As of Q1 2026.

4. Source: RCA. As of Q4 2025.
5. Source: CBRE Global Investor Intentions Survey. As of March 2026
6. Source: Chatham Financial. As of Q1 2026.
7. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q1 2026.

Occupier Markets

OFFICE SECTOR

European office take-up reached 8.9 million sq m in 2025, marginally below 2024 levels (9.1 million sq m) and 15% below the 10-year average.[8] Given the softer growth outlook, a strong **demand pick-up is unlikely**, at least in the near term.

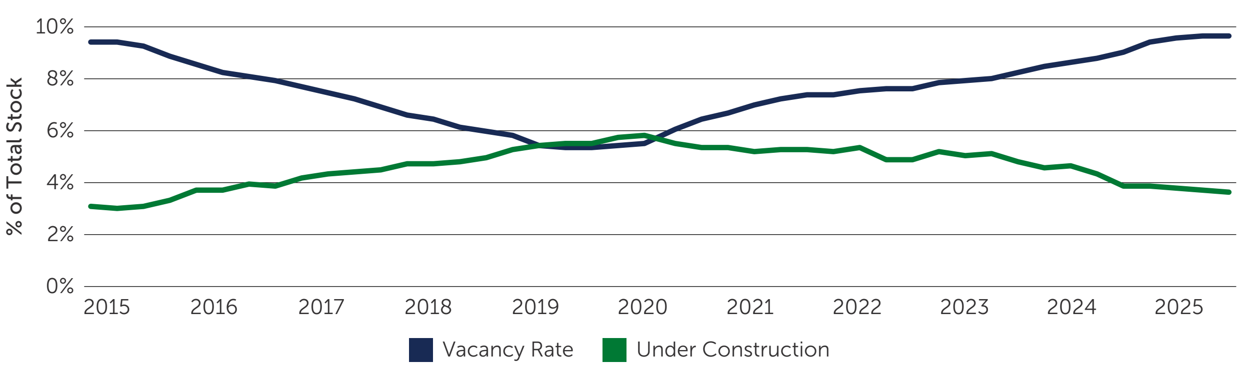
European office vacancy edged up to 9.7% in Q4 2025, up from 9.0% a year earlier. However, there are tentative signs that the upward trajectory is flattening, suggesting that **vacancy levels may be approaching a cyclical peak**.

Challenging developer market conditions have curtailed construction activity. Only 8.8 million sq m were under construction at the end of Q4 2025, down from a peak of 12.4 million sq m in Q1 2023. The post-pandemic pricing correction, combined with inflation-driven upward pressure on build costs, will test the feasibility of new projects. As a result, **further slowing in the development pipeline is likely**, with start dates deferred for schemes yet to break ground.

AI advances have raised concerns around the future of some office jobs and the impact on demand. Core CBD offices with strong transport links are expected to be most resilient to any immediate and long-term disruption, with obsolescence risks greatest for secondary office buildings and locations.

In the year through to March 2026, prime office rents increased 5.5% per annum, comfortably outperforming all-property at 4.8% per annum.[9] Severe supply constraints of modern CBD office space across Europe's key cities continue to **drive rental outperformance at the top end of the market**.

Figure 3: European Office Supply



Source: Cushman & Wakefield. As of Q4 2025.

8. Source: Cushman & Wakefield. As of Q4 2025.
9. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q1 2026.

RETAIL SECTOR

Eurozone consumer confidence declined to a three-year low at -20.6 in April 2026, down from -16.4 in March 2026.[10] This reflects rising household caution in response to a more uncertain economic outlook.

Retail sales growth appears to be losing momentum. Month-on-month sales declined by 0.2% in February, while annual sales moderated to 1.7% per annum.[11]

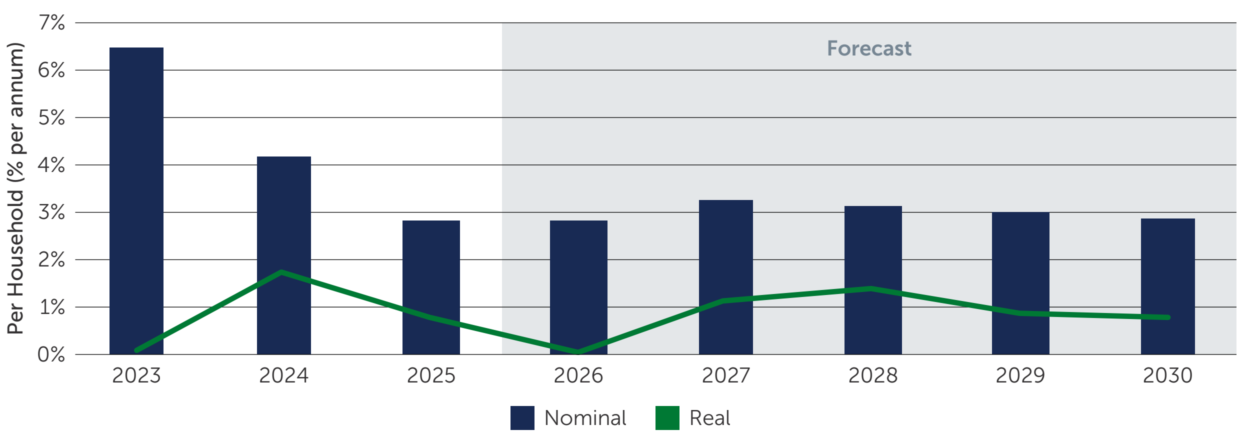
Higher oil and energy prices are expected to squeeze household disposable income levels, weighing on consumer spending. With labour market conditions softening, **wage growth is unlikely to fully offset rising price pressures**.

In response, retailers continue to rationalise and optimise their store networks across Europe, prioritising larger flagship stores in prime high-street locations while disposing of secondary locations.

The concentration of retailer demand on prime retail pitches likely supported the 1.2% quarter-on-quarter rise in prime high-street rents in Q1 2026.[12]

Annual rental growth remained healthy at 3.9% per annum, although this was notably lower than the 6.3% recorded a year earlier. **Tougher consumer spending conditions could weigh on the pace of future rental growth**.

Figure 4: Household Disposable Income Projections



Source: Oxford Economics. As of April 2026.

10. Source: Eurostat. As of April 2026.
11. Source: Eurostat. As of February 2026.
12. Source: CBRE, Cushman & Wakefield, Barings Research. As of Q1 2026.

INDUSTRIAL SECTOR

CBRE reports that total logistics take-up in Europe was up 27% in Q4 2025, with 7.4 million sq m of leasing activity. This brings the annual total in line with the 2024 level. While recent geopolitical events will test demand resilience in the months ahead, **prolonged uncertainty can also increase the need for greater contingency and storage space in supply chains**.

Strong year-on-year growth in leasing activity was observed in the larger markets, with rises of 9% in the U.K., 7% in Italy and 6% in Germany. This strength was partially offset by double-digit declines in Belgium, Sweden and the Netherlands.

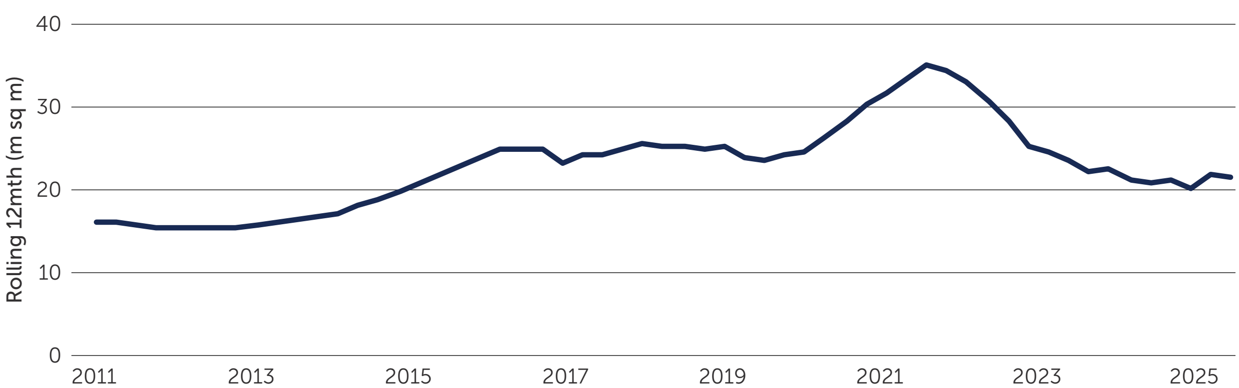
JLL reports that 3PLs accounted for the most leasing activity in 2025 at 42%, followed by retailers and e-commerce (27%) and manufacturing (21%).

According to CBRE, European logistics vacancy has stabilized at 5.5% in recent quarters, although the rate is still around 75 bps higher year-on-year.

Annual logistics development completions fell to an eight-year low, which should support the absorption of existing vacancy and push rental growth upward. JLL reports that the proportion of speculative space under construction continues to decline (now only a third of space under construction), with activity concentrated in a small number of select prime markets.

Industrial rents increased by 5.0% per annum in the 12 months to Q1 2026, accelerating from 3.3% per annum in the previous 12 months. France led the upswing, with Paris rents rising by 12%, while many other major markets recorded growth above 5%. Germany was the exception, with all major markets remaining positive but below 5% per annum.

Figure 5: European Industrial Take Up



Source: JLL. As of Q4 2025.

LIVING SECTOR

Developments in Iran have added uncertainty to the mortgage rate outlook. At the same time, a softer labour market and early signs of weakening consumer sentiment (see retail section) are all **likely to ease momentum for future transactions**.

Prior to the conflict, house price growth was strong, with the Eurozone recording an average annual growth rate of 5.4%[13] in 2025. Spain outperformed, with prices increasing by 12.9% per annum, while Italy and Germany also posted solid outcomes at 4.1% and 3.0%, respectively. France and the U.K. were at the softer end of the spectrum, recording growth of 1.1% and 2.2% respectively.[14]

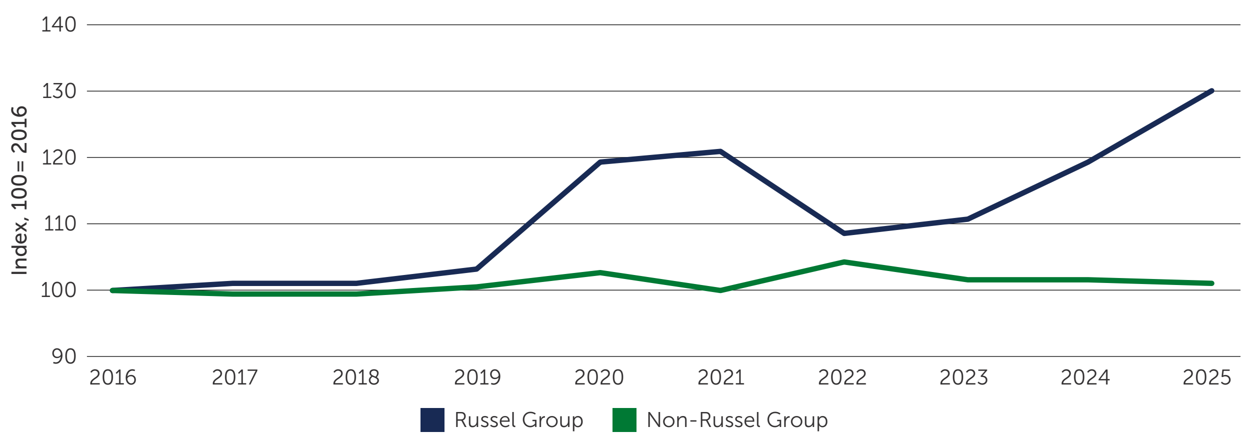
Oxford Economics' latest projections (April 2026) forecast average annual **house price growth of 4.9% per annum through 2028**. However, revisions are likely, with the magnitude dependent on the duration of the Iran conflict.

If labour market conditions soften further, this could potentially lead to an increase in student numbers, supporting demand for purpose-built student accommodation (PBSA).

At the same time, technological advances have expanded the delivery of online education, including university-level courses, raising concerns that this could erode demand for PBSA. To help mitigate this risk, **investors may benefit from targeting assets linked to higher-ranked institutions, which are likely to be more resilient to online learning trends**.

In the U.K., this is demonstrated by application trends at prestigious Russell Group institutions, where accepted applications have increased by 30% since 2016, compared with growth of just 1% at other institutions.[15]

Figure 6: U.K., Accepted UCAS Applications



Source: UCAS (Universities and Colleges Admissions Service). As of 2025.

13. Source: Oxford Economics. As of April 2026.
14. Source: Oxford Economics. As of April 2026.
15. Source: UCAS. As of April 2026.

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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