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Europe comes out “Top Trumps” in global real estate battle

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Key takeaways

- Resilient European real estate fundamentals, particularly versus U.S. markets, will facilitate income growth, even in a period of weak economic activity.
- Greater certainty on net zero transition in Europe underpins a secular strand of investment opportunities in the future-proofing of assets through refurbishment and repositioning.
- Historic levels of fiscal stimulus are expected to boost Europe's largest economy over the next five years, while progress on controlling inflation leaves greater leeway for monetary policy to support growth in the near term, if required.

While we are still in the eye of the storm as far as understanding the full ramifications of “Liberation Day” and the subsequent toing-and-froing on announced tariffs, the relative outperformance of the listed European real estate sector over this period reflects at least in part the defensive growth characteristics of the property market in Europe, typified by the low vacancy rates that prevail across most sectors and countries which should drive income growth even against the backdrop of lower economic growth due to tariff uncertainty.

As a rate-sensitive asset class, European real estate has also been supported by the lowering of short-term interest rate expectations and long-term government bond yields since the tariffs were announced. Until very recently, these had been a headwind after the large package of fiscal measures announced by the new German government in March led to a sell-off in sovereign bonds. This illustrates how quickly dynamics are shifting in the current market. Much will change as we progress through the coming weeks and months, but this is an opportune time for a pulse check on the “battle readiness” of European real estate, while drawing comparisons with the U.S. In the “Top Trumps” of global real estate markets, Europe may well be the best positioned.

The key factors to consider in addition to moderate vacancy rates are that future supply in Europe is largely constrained, rents continue to grow, and there is an entire strand of secular growth opportunities linked to the decarbonization of assets. At a macro level, fiscal spending will support medium-term economic growth, and a more balanced inflation outlook means monetary policy can act as a stronger crutch through the near-term uncertainty that lies ahead, if required.

Supply-side dynamics are the unsung hero of the last cycle in Europe.

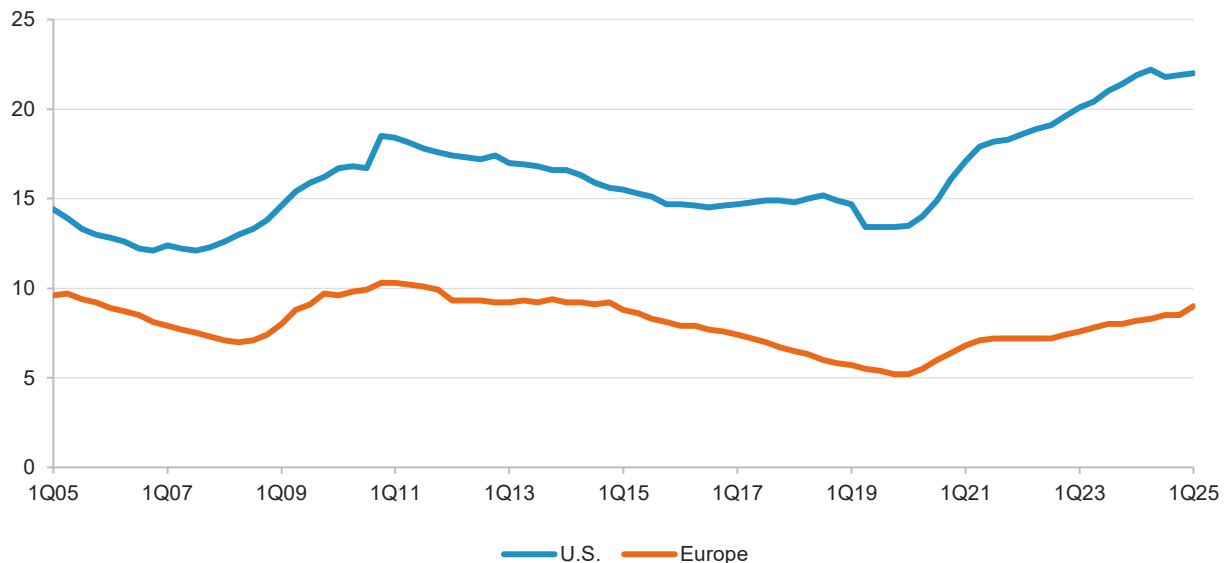
In a sector where much of the attention is paid to the demand side of the equation in occupier markets, it is too easy to overlook slower-moving supply side dynamics. Unusually, the repricing of European real estate over the last two and a half years has not been accompanied by oversupply of real estate space, despite the two typically coinciding. This was initially due to the COVID pandemic, which dented appetite for speculative development, followed up by real challenges in underwriting construction costs as the war in Ukraine and supply chain disruption took hold. Vacancy rates have increased on the whole, but they remain well below previous cyclical highs in Europe.

The U.S. market, in contrast, has endured yield-driven repricing, with a classic cycle of oversupply on top, which has resulted in office vacancy rates at all-time highs, averaging over 20%, while European levels are still below the global financial crisis highs at 8%. The same has been borne out in the logistics sector where a steeper decline in occupier demand and a flurry of new space coming to market meant U.S. rents grew by 0.6% last year, compared with Europe's 3.5% on average¹.

¹ JLL Global Real Estate Perspective, February 2025.

Recent performance is no guarantee of future outcomes, particularly in times of such significant change, but what is clear is that European real estate comes into this period of uncertainty with a supply/demand balance much closer to equilibrium than that of the U.S.

U.S. office vacancy rates at 20-year high; Europe's remain low.



Source: Fidelity International and JLL Global Real Estate Perspectives, February 2025.

The European brown-to-green transition is still on solid foundations

From a structural theme perspective, the drive to decarbonize and reach net zero appears to be at a relatively low ebb in the U.S. today, driven partly by the current administration's scepticism on the issue. Indeed, Europe is reevaluating some of its own commitments to the net zero transition with competitiveness increasingly front of mind. However, the overarching ambition among policy makers and European corporates remains steadfast.

This is underpinning a secular alpha-generation opportunity that investors can tap into: to decarbonize and future-proof buildings, while enhancing the overall value proposition for occupiers. The energy efficiency gains delivered through a "greening" of assets, in what is a high energy cost region, ensures it is more than just a moral imperative for European occupiers to be in green space but increasingly represents value for money. We expect this driver will only strengthen as occupiers become increasingly cost-conscious in the current environment.

Over the short term, the focus remains on the immediate impacts of tariffs on the global economy, with European and U.S. activity expected to take a significant hit due to the uncertainty and demand impact of rising prices. Over the medium term, however, it is worth remembering the one trillion euros of fiscal spending by the end of the decade announced by the German government in early March, with half the money to be directed to fortifying German defence and the other 500 billion euros on modernizing the country's infrastructure. This is an even larger fiscal stimulus than that implemented during the COVID pandemic, and the largest since German reunification.

This large stimulus had been expected to boost German annualized growth by 0.7%, taking it to around 1.8% per annum over the next four years.² This will again be revised as the true extent of tariffs implemented becomes clear over coming months, but nonetheless this is a significant support to Europe's largest economy that will have positive spillovers for the wider region too.

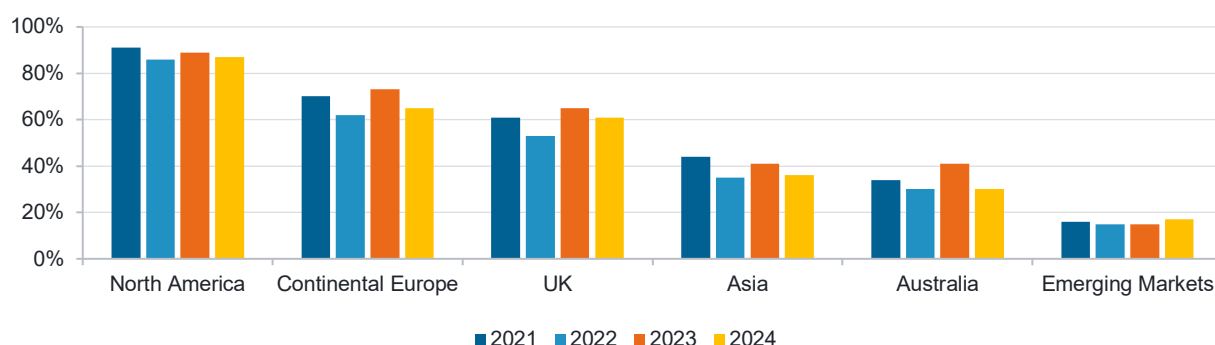
² Oxford Economics, March 2025.

The top-down view on real estate capital markets

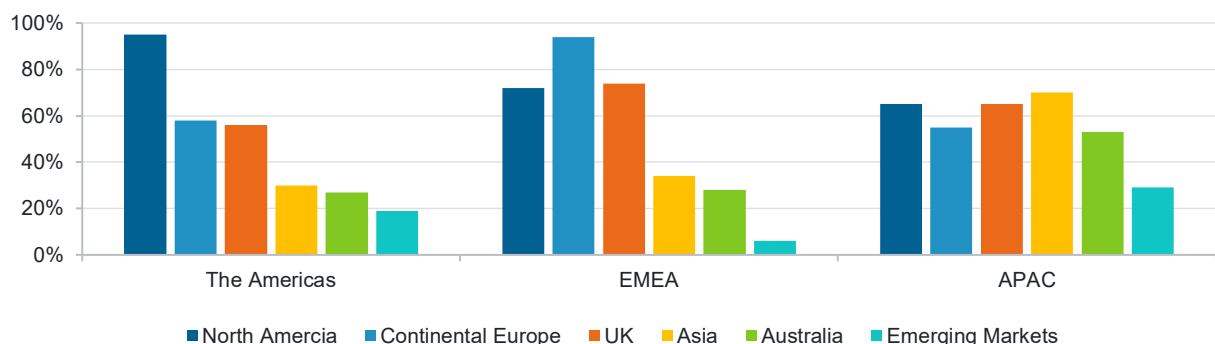
From a real estate capital markets perspective, we expect the rise in uncertainty to delay the recovery in deal activity again across all global markets. Indeed, the trajectory of long-duration U.S. Treasuries over recent weeks may indicate that investor sentiment towards the U.S. has been undermined on a more-than-fleeting basis. As such, it is conceivable that some of the international capital that had been drawn to the U.S., due to its recent strong economic performance, may now be diverted elsewhere. Correspondingly, recent commentary from some large global investment managers highlights how investors are recalibrating exposures to the region.

As the data below on institutional real estate allocations shows, the U.S. has had a disproportionately strong pull, attracting international capital flows. If European and Asia-Pacific capital is partially redirected towards Europe as a result of economic turbulence in the U.S., this could aid investment market liquidity in 2026, and potentially beyond.

Geographic focus, all institutions



Geographic focus, by location of institution



Source: Institutional Real Estate Allocations Monitor, Cornell University and Hodes Weill & Associates, 2024

Liquidity in debt markets has recovered very robustly, and European banks remain well capitalized, with modest non-performing loan exposures in the real estate sector. The risk of a credit crunch due to current threats therefore is very limited. The recent decline in interest rate expectations should also provide some protection against valuation write downs in Europe and support with refinancing.

Liquidity in debt markets has recovered very robustly, and European banks enter this cycle with relatively modest loan exposures to the real estate sector, reported at 10.7% of loan assets by the European Banking Authority.³ U.S. bank exposures to real estate are higher across the board, at 12.4%, but materially so at smaller lenders, with concentrations upwards of 30%. Indeed, smaller lenders in Europe also have higher relative exposures, but the strength of fundamentals of the underlying assets between the U.S. and Europe is materially different. So too is the growth of loans written at the peak of the market in the U.S. compared with more moderate late-cycle real estate loan growth in Europe.⁴

³ European Banking Authority, Risk Assessment Report, July 2024.

⁴ <https://www.fidelityinternational.com/editorial/article/european-commercial-real-estate-remains-more-robust-than-us-4b5a32-en5/> (en anglais)

Overall, therefore, the robustness of the European real estate credit market looks in somewhat better shape than that of the U.S., albeit with no material cracks showing so far on either side of the Atlantic. The recent decline in European sovereign bond yields and interest rate expectations should also provide some protection against valuation writedowns in Europe and support with refinancing.

The picture in the U.S. is less clear: on the one hand, the heightened probability of recession could catalyse further interest rate cuts, but on the other, soaring inflation expectations may limit the headroom to do so. Improving investor sentiment is therefore a key prerequisite for unlocking further growth in deal volumes in Europe, with some additional challenges to unlock first in the U.S.

So, while the unwelcome developments that came from Liberation Day are still unhelpful for European real estate, the strong underpinnings and primarily domestic orientation of the sector position it as “battle ready” for the challenges and uncertainty that lie ahead – perhaps even more so than Europe’s armies!



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