

IQEQ

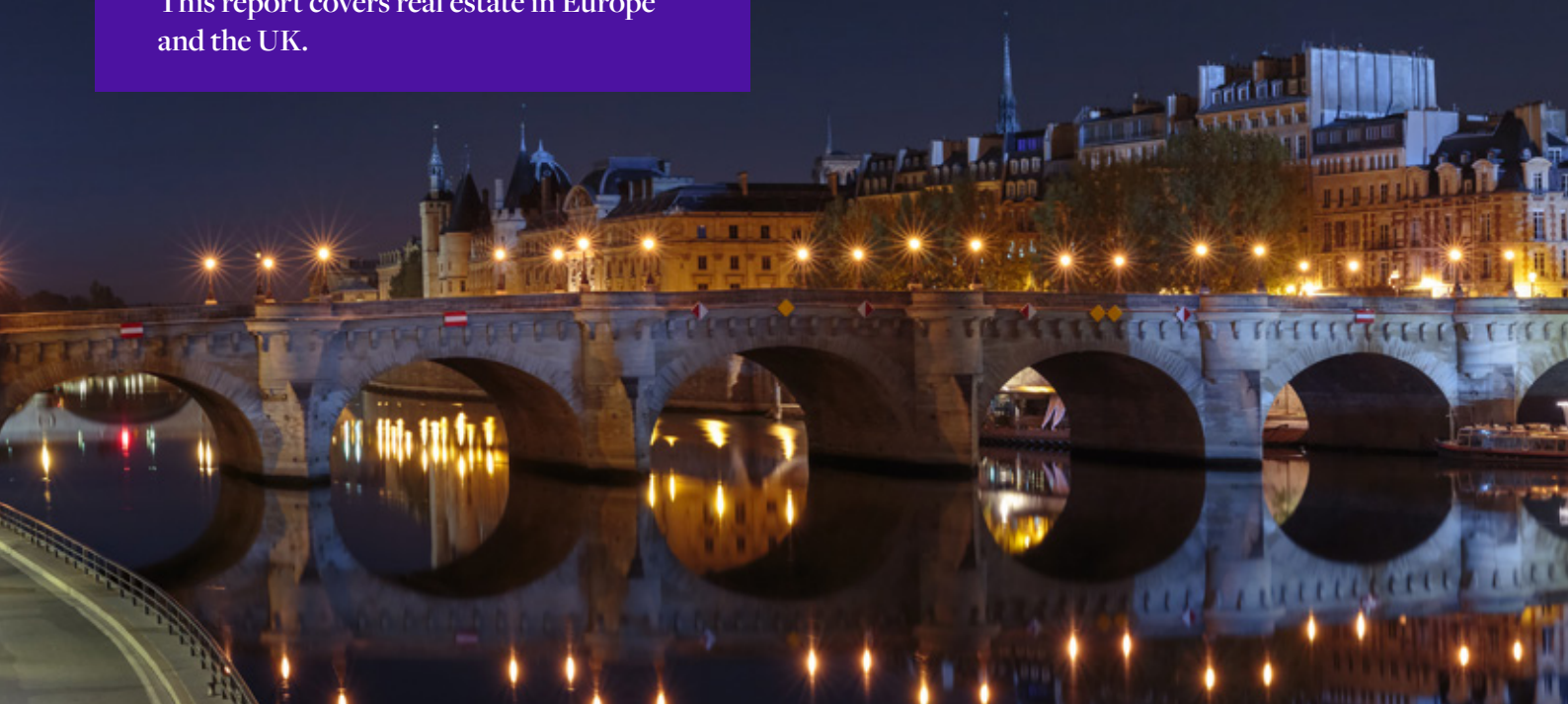


Real estate in Europe and the UK

September 2024



This report covers real estate in Europe and the UK.



Introduction

Over the past year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and aggressive monetary policy tightening across advanced economies.

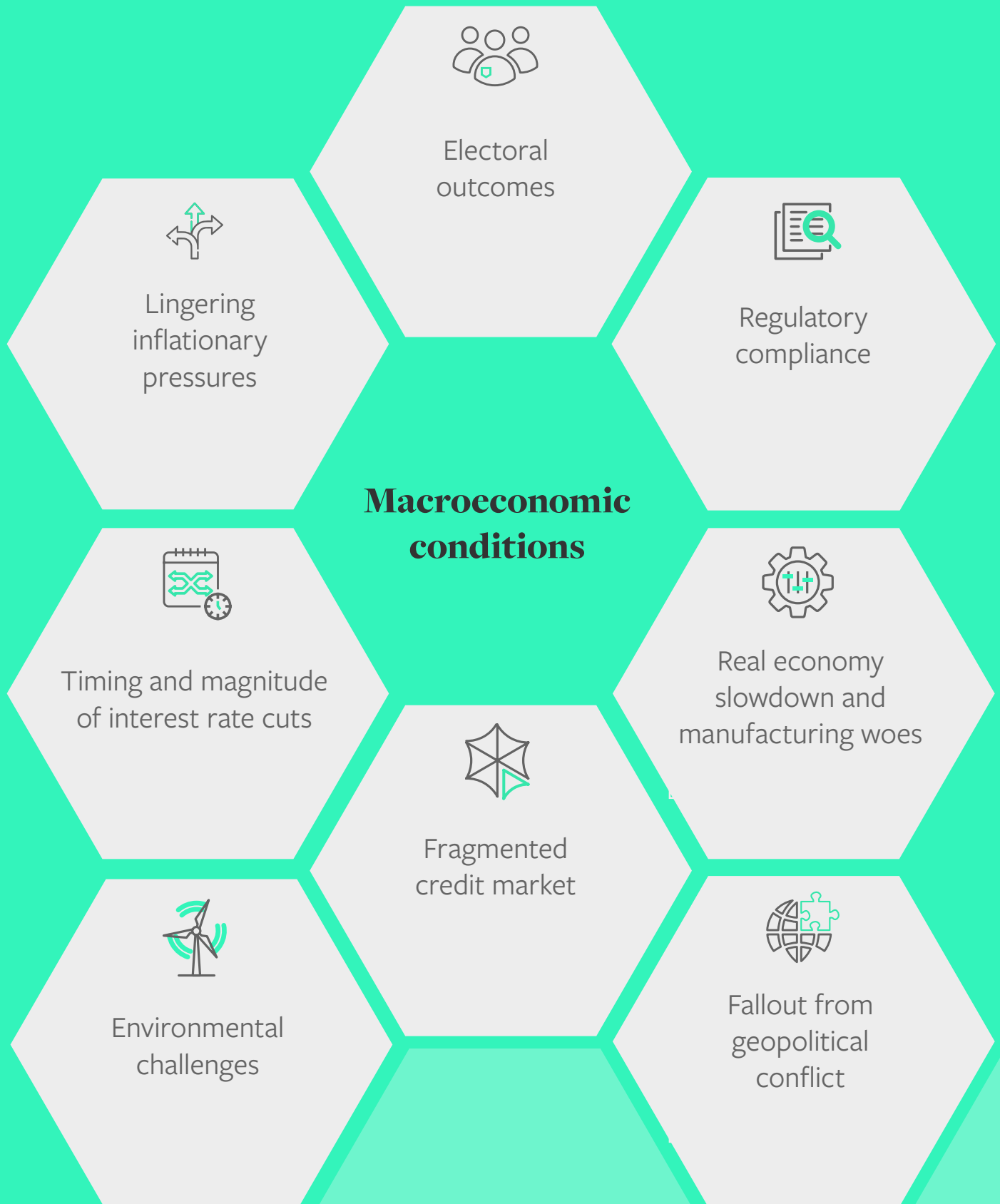
These headwinds precipitated a global downturn, injecting significant uncertainty into markets. Private markets, in turn, faced substantial pressure, with some notable exceptions across strategies and regions.

As we move into the latter half of 2024 and into 2025, a more optimistic landscape emerges. Major economies are seeing disinflationary trends, increasing the likelihood of interest rate cuts. A few central banks, including the Bank of Canada, the European Central Bank (ECB), and the Bank of England (BoE) have already implemented policy loosening in recent months. The U.S. is expected to follow suit, making progress on inflation despite signs of persistence, with at least one rate cut anticipated this year.

Optimism surrounding a more accommodative borrowing environment sets the stage for a potential resurgence in private market activity. However, broader uncertainty is expected to linger due to geopolitical tensions, the prospect of significant shifts in the global political order amid numerous elections in 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we examine how these conditions will influence the outlook for private markets in the latter half of 2024 and into 2025. Our comprehensive series of reports will scrutinise the prospects for real estate across diverse geographical regions. We provide insights into how investors can navigate current market dynamics and leverage opportunities strategically to their advantage.

Macroeconomic overview



Headline inflation in Europe and the UK showed a disinflationary trend in the first half of 2024, though such a development has also been accompanied by lingering domestic price pressure, as seen via relatively sticky, elevated services inflation.

Despite this, both the ECB and the BoE opted to cut interest rates in recent months. The ECB's cut in June marked the first rate cut in nearly five years, partly to stimulate economic activity within the bloc. In the UK, inflation hit the BoE's target of 2.0% in May for the first time in three years, and this alongside a partial unwinding of the labour market, likely prompted the BoE to embark on a cut.

Unlike the U.S., Europe and the UK have not experienced resilient growth under tighter monetary conditions. Both regions ended 2023 with poor growth, with the UK entering a technical recession in the second half of 2023. However, there have been signs of improvement, with both economies recording quarterly growth in Q1 2024. Cebr forecasts the UK economy to grow by 1.2% in 2024, while the Eurozone is expected to grow by 0.8%. Despite these improvements, growth remains relatively subdued.

Even with the recent rate cuts, interest rates are likely to remain above pre-pandemic levels through 2024 and 2025. Central bankers are expected to maintain restrictive rates to manage inflationary pressures, which could expose financial vulnerabilities for issuers facing limited access to financing and higher service costs.

Additionally, 2024 has seen significant political changes, including a new government in the UK and major political shifts in key European Union (EU) member states such as France. These changes add uncertainty to policy and regulatory frameworks. Ongoing geopolitical tensions, notably the Russia-Ukraine conflict and conflicts in the Middle East, also present challenges that could impact the overall economic outlook.



Overview of the global real estate market

In 2023, subdued fundraising within the real estate sector persisted due to historically elevated interest rates, which raised borrowing costs and limited financing availability.

This trend appears to have continued into the first half of 2024, exacerbating challenges faced by key players in the real estate asset class. Coupled with valuation uncertainties, these factors led to a significant decline in global deal activity, hitting a decade-low of \$645 billion across 2023¹. The subdued transaction environment also impacted closed-end fundraising, which dropped by 34% to \$125 billion in 2023, compared to 2022². Overall, global fundraising for real estate declined by 26% in 2023³, with Q1 2024 seeing only \$19.8 billion raised, marking the lowest quarterly figure since 2011⁴.

Throughout 2023, every strategy within the real estate investment sphere experienced a decline. Specifically, there was a notable shift away from core and core-plus strategies, known for their low risk but stable returns, with fundraising pertaining to this strategy dropping by 51% in 2023⁵. This shift reflects investors' increasing demand for liquidity amidst constrained exit opportunities due to wider bid-ask spreads. Consequently, capital has been tied up for longer periods with delayed returns. In contrast, opportunistic strategies saw a smaller decline of 18%, benefiting from the shift away from traditional core and core-plus investments⁶.

In the first quarter of 2024, the trend away from core and core-plus strategies continued, with such strategies accounting for only 3% and 9% of funds raised⁷, respectively. Investor preference for higher returns remains evident, with a strong inclination towards value-added strategies, which accounted for 71% of funds raised in Q1 2024⁸.





In addition, global fundraising for both closed-end and open-end funds fell in 2023. For closed-end funds, this reflected a preference among investors for allocating their capital to larger, well-established funds, a trend similar to that observed in private equity. Indeed, funds exceeding \$1 billion accounted for over 64% of overall fundraising, marking a notable increase from 51% in 2022.⁹ Returns on this asset class witnessed weak performance, recording a -3.5% internal rate of return (IRR) through the first three quarters of the year. This represents the first occurrence of negative returns for this class since the Global Financial Crisis (GFC). Open-end fund performance also declined considerably, with NFI-OE funds returning -12.2% on a net basis, experiencing the first annual decline since the GFC.¹⁰

The real estate sector is grappling with the dual impact of tighter monetary conditions and pandemic-induced shifts in behaviour, including reduced office occupancy and urban migration trends.

These changes have disproportionately affected certain property types, notably offices and retail spaces. In 2023, the office sector saw the sharpest decline in annual returns among all real estate sectors, plummeting by 17.6%. Fundraising for office spaces continued its downward trend, with no capital raised in Q1 2024, contrasting sharply with the 8% share of capital raised in 2019.¹¹ In contrast, the hospitality sector has demonstrated notable improvements, contributing 15% of total fundraising in Q1 2024, highlighting a shift in investor preference.

Despite lower fundraising, the real estate asset class accumulated capital throughout the year in 2023. Dry powder in closed-end real estate funds surged by 19% in the first six months of 2023. Indeed, dry powder in this asset class has grown by 13% per year over the past half-decade, reflecting a pool of funds ready for investment, even amidst a backdrop of diminished fundraising efforts.¹²

Looking ahead to the second half of 2024 and into 2025, indications point towards the market potentially having bottomed out in the first half of the year. This sets the stage for a potential normalisation in the real estate sector, aligning with post-pandemic trends and amid tightening monetary policy. However, investors will encounter ongoing challenges and opportunities as they navigate evolving preferences, macroeconomic shifts, and the dynamics reshaped by the pandemic.

Navigating fundraising and exit strategies in Europe and the UK amidst prevailing macroeconomic conditions

Deal activity and fundraising remained subdued across Europe and the UK amidst tighter monetary conditions. Indeed, fundraising for European closed-end funds fell to \$22 billion in 2023, marking a 14% drop from 2022 levels.¹³ Overall, in 2023, fundraising in the European and UK real estate sector experienced a decline of 6%, decreasing from \$28 billion in 2022 to \$26 billion.¹⁴

This subdued fundraising level has continued into 2024, with only \$1.0 billion raised in Q1 2024 in Europe, allowing the Asia-Pacific region to overtake Europe as the second most attractive destination for capital.¹⁵

In contrast to the U.S. however, this region witnessed a decrease in available dry capital in 2023 compared to 2022. Nevertheless, there remains \$66 billion in capital to deploy, suggesting that there is some capital available to seize investment opportunities as they arise.¹⁶ In line with a global shift, investors are increasingly moving their capital from traditional core and core-plus strategies to pursue more liquid investments. Currently, only 21% of capital is designated for core and core-plus strategies, while a significant 63% is targeted towards value-add and opportunistic strategies.¹⁷ For the real estate sector in Europe and the UK, this shift could drive increased innovation and rejuvenation in underutilised properties, potentially revitalising markets and expanding development opportunities in the latter half of 2024 and into 2025.

The real estate sector in Europe benefits from its strategic geographic position bridging the U.S. and Asia, offering distinct advantages in investment, development, and transportation. Cities across Europe differ in their appeal to investors, with some providing better opportunities due to their robust liquidity and stability, especially in times of economic uncertainty. Notably, London remains a prime destination for real estate investment due to its capacity for wealth preservation and income generation. Meanwhile, cities like Milan, Lisbon, and Brussels are gaining popularity among investors. For the European real estate outlook, this geographical positioning and city-specific appeal suggest a continued influx of capital, providing optimism for growth in the sector in 2025 and beyond.

Moreover, Europe faces unique geopolitical and macroeconomic challenges that impact its real estate market, notably due to ongoing migration flows. These migrations

exacerbate the existing housing shortages, increasing demand for residential real estate investment. As cities struggle to meet housing needs, the pressure to develop and invest in new residential projects is likely to intensify, directing more capital into housing developments and potentially boosting local economies. Recent political changes, particularly in the UK, have significant implications for the real estate sector. The Labour Party's manifesto, which includes plans to build more affordable housing, could have a long-term impact by alleviating current pressures and reshaping market dynamics.

The post-pandemic shift in behaviour is also expected to have a profound impact on the real estate sector, particularly in how office spaces are utilised. With remote and hybrid working models still currently in place, demand for traditional office spaces has declined, leading to increased vacancy rates in major business districts such as Canary Wharf in London.¹⁸ Companies are downsizing their office footprints or seeking more flexible lease terms to accommodate a workforce that no longer needs or wants to be in the office five days a week. This trend is prompting a re-evaluation of commercial property strategies, with an increased focus on converting office spaces into residential or mixed-use properties to meet changing demands. This is likely to continue, given ongoing developments specifically within Canary Wharf, and will present new opportunities to investors moving forward.

Moreover, there is a growing interest in satellite offices in suburban areas, which are expected to benefit from the decentralisation of work locations. This shift could revitalise local economies outside major city centres and alter investment patterns within the real estate sector, potentially stabilising the market as it adapts to new work-life realities and the rise of digital nomads.

With potentially more rate cuts on the horizon in the latter half of 2024 and into 2025, such a development could potentially alleviate the difference bid-ask spreads and facilitate easier exit strategies for investors over that time period. Markets are anticipating a stabilisation in property valuations as all parties adjust to the prolonged high-interest rate environment. This prospective easing of interest rates could inject liquidity into the market, providing relief and fostering a more favourable environment for transactions in 2025.

References

1 [McKinsey \(2024\), Private markets: A slower era](#)

2 Ibid

3 Ibid

4 [PERE \(2024\), Q1 2024 fundraising remains at a 12-year low](#)

5 [McKinsey \(2024\), Private markets: A slower era](#)

6 Ibid

7 [PERE \(2024\), Q1 2024 fundraising remains at a 12-year low](#)

8 Ibid

9 [McKinsey \(2024\), Private markets: A slower era](#)

10 Ibid

11 [PERE \(2024\), Q1 2024 fundraising remains at a 12-year low](#)

12 [McKinsey \(2024\), Private markets: A slower era](#)

13 [McKinsey \(2024\), Private markets: A slower era](#)

14 Prequin





15 [PERE \(2024\), Q1 2024 fundraising remains at a 12-year low](#)

16 [CBRE \(2024\), European Real Estate Market Outlook 2024](#)

17 Ibid

18 [CityAM \(2024\), London office vacancy rates to rise in City, Wharf and West End amid Wework trouble](#)

Degree of opportunity for real estate markets posed by macroeconomic conditions

Development	Degree of opportunity for asset class		
Expected interest rate cuts			
<p>The ECB and BoE both have implemented their first rate cuts. Such cuts would reduce the cost of acquisition financing, enabling investors to leverage their real estate deals more effectively. However, interest rates are unlikely to drop to their pre-pandemic lows, which will likely mean only a slight easing in bid-ask spreads. While this is expected to enhance the potential for deals and fundraising activities, it will likely not be to the extent witnessed during the pre-pandemic period.</p>	 HIGH	MEDIUM	LOW
Investment in residential and housing real estate			
<p>Investing in residential and housing real estate in Europe and the UK presents an enticing opportunity for investors. The sector is currently grappling with a persistent demand-supply imbalance. Factors such as dwindling development pipelines, funding constraints, escalating construction costs, and uncertain exit valuations have contributed to the supply shortage. Despite these challenges, the scarcity of supply amid rising demand is poised to propel property values upwards, offering investors the prospect of capital appreciation upon exit. Additionally, investors can enjoy a steady income from growing rent. Indeed, elevated mortgage rates have resulted in renting being more affordable than home ownership for many, thus driving demand towards rental properties. Moreover, the influx of net migration into the region further fuels housing demand. Groups such as Ukrainian refugees, Hong Kong citizens seeking British residency, and South American migrants relocating to Spain contribute to population growth, bolstering the need for housing.</p> <p>The combination of supply shortage, increasing demand, and demographic shifts underscores the allure of investing in residential and housing real estate in Europe and the UK.</p>	 HIGH	MEDIUM	LOW
Retail and tourism investment			
<p>Investment in retail and tourism real estate also stands as a lucrative opportunity for investors in Europe and the UK in 2025 and beyond. The slowdown in inflation coupled with strong nominal wage growth are anticipated to bolster the outlook for consumers, resulting in a positive impact on retail sales. E-commerce is expected to continue its growth, which will likely increase opportunities in the warehousing and storage space, albeit at a slower pace. Meanwhile, retailers are also shifting their focus towards flagship store formats strategically positioned in prime locations, presenting an alternate opportunity for new investors.</p> <p>Moreover, Europe's hotel and tourism sector is poised for further growth, fuelled by a surge in domestic and shorthaul leisure travel, which remains the primary driver for hotel demand. An additional boost is anticipated from international long-haul leisure travel, particularly from Asian markets.</p>	 HIGH	MEDIUM	LOW
Growing pressures around ESG compliance			
<p>ESG compliance is becoming increasingly important for real estate investors. The Energy Performance of Buildings Directive from the European Commission sets clear sustainability targets and deadlines. However, many existing EU buildings have low energy efficiency ratings, and their traditional builds make it challenging to renovate them to meet these standards.</p> <p>The Directive mandates that EU housing achieve a minimum Energy Performance Certificate (EPC) rating of class E by 2030 and class D by 2033. Achieving these goals requires significant investment in retrofitting existing buildings for improved energy efficiency and reduced carbon emissions. As pressure mounts for ESG compliance, real estate investors face the task of integrating environmental, social, and governance factors into their strategies, which opens up opportunities but also poses challenges.</p>	HIGH	 MEDIUM	LOW

Key contacts



Justin Partington
GROUP HEAD OF FUNDS
AND ASSET MANAGERS

E Justin.Partington@iqeq.com



Tamas Mark
GLOBAL HEAD
OF REAL ASSETS

E Tamas.Mark@iqeq.com



Bram Eijsbout
CHIEF COMMERCIAL OFFICER,
LUXEMBOURG & NETHERLANDS

E Bram.Eijsbouts@iqeq.com



Romain Mifsud
CHIEF COMMERCIAL OFFICER,
FRANCE AND SWITZERLAND

E Romain.Mifsud@iqeq.com



Mark Luijcks
HEAD OF REAL ESTATE,
THE NETHERLANDS

E Mark.Luijcks@iqeq.com



Mirek Gruna
REGIONAL CCO, UK, IRELAND
AND CROWN DEPENDENCIES

E Mirek.Gruna@iqeq.com



Stuart Pinnington
HEAD OF ALTERNATIVE ASSETS,
JERSEY

E Stuart.Pinnington@iqeq.com

This note is for informational purposes only and does not constitute financial advice, investment guidance, or an endorsement or recommendation for any particular security or trading strategy. The information contained herein is not intended to be a source of advice or credit analysis with respect to the material presented, and the information and/or documents contained in this note do not constitute investment advice.

This publication has been issued by IQ-EQ Group Holdings SA on behalf of certain companies that form part of IQ-EQ Group. The publication has been prepared for general circulation to clients and intermediaries and does not have regard to the circumstances or needs of any specific person who may read it. Nothing in this publication constitutes legal, accounting or tax advice or investment advice.

The information contained in this publication has been compiled by Cebr and/or its affiliates from sources believed to be reliable, but no representation or warranty, express or implied is made to its accuracy, completeness, or correctness. All opinions and estimates contained in this report are judgements as of the date of publication and are provided in good faith but without legal responsibility.

For information on the legal and regulatory status of our companies, please visit www.iqeq.com/legal-and-compliance

Follow us

