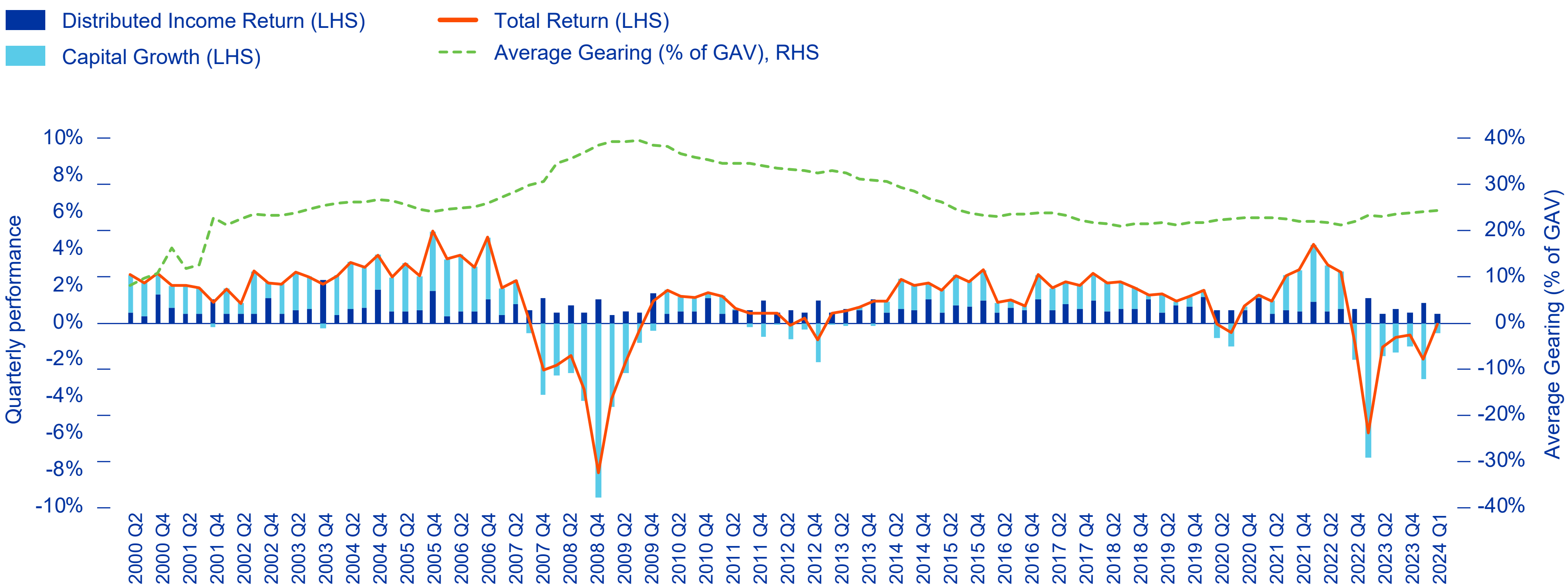
Market Insights on European non-listed real estate in June 2024

The latest edition of the INREV Market Insights indicates that the significant market correction of European real estate seems to have slowed down. The Q1 2024 INREV Fund Index reported a total return of 0.00%, an improvement from -1.90% in Q4 2023.

Due to the seasonality effect, a significant adjustment in the Q1 performance is unlikely. Capital growth remained the primary driver of negative performance at -0.50%, despite of a 251 basis points (bps) quarter-on-quarter improvement. Distributed income return declined from 1.11% in Q4 2023 to 0.50% in Q1 2024, influenced by many funds' year-end income distribution practices. The one-year rolling distributed income return is now 3.08%.

Figure 1: European non-listed real estate performance

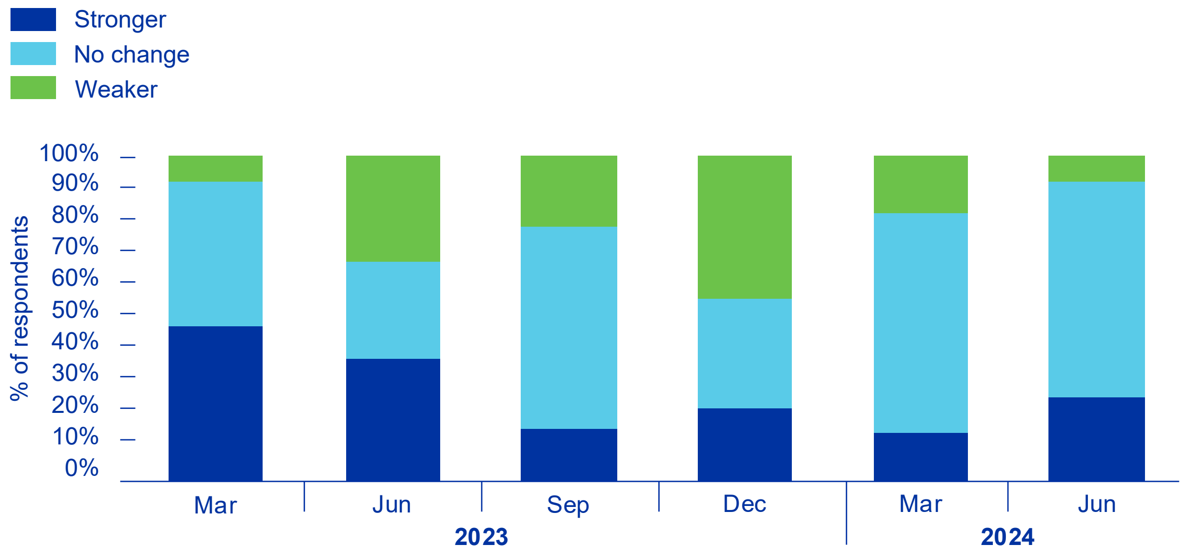


Source: INREV Quarterly Fund Index, Q1 2024

Current economic conditions, particularly the 25 bps ECB interest rates cut in June 2024, signal a tentative shift towards a more optimistic market outlook after a challenging two years. Furthermore, participants in the Consensus Indicator Survey (see Figure 2) anticipate stronger European GDP growth over the next 12 months, reflecting a substantial positive shift compared to 2023.

The latest June INREV Consensus Indicator, designed to capture market sentiment and turning points, shows a second consecutive improvement, with a headline reading of 53.6, up from 50.2 in March 2024 (see p.9 for more details).

Figure 2: European GDP growth outlook for the next 12 months: change since the previous quarter



Source: INREV Consensus Indicator Survey, 2024

European asset level performance turns positive

The Q1 2024 INREV European Asset Level Index entered positive territory with a total return of 0.41%, a 207 bps quarter-on-quarter improvement. Performance dispersion between the index's four main markets narrowed from the high levels seen last year.

The Netherlands (1.08%) and the UK (0.49%) showed modest positive performances, leading the main markets, while Germany and France stayed in the negative territory with -0.09% and -0.43%, respectively. Returns improved across all major sectors in these four geographies.

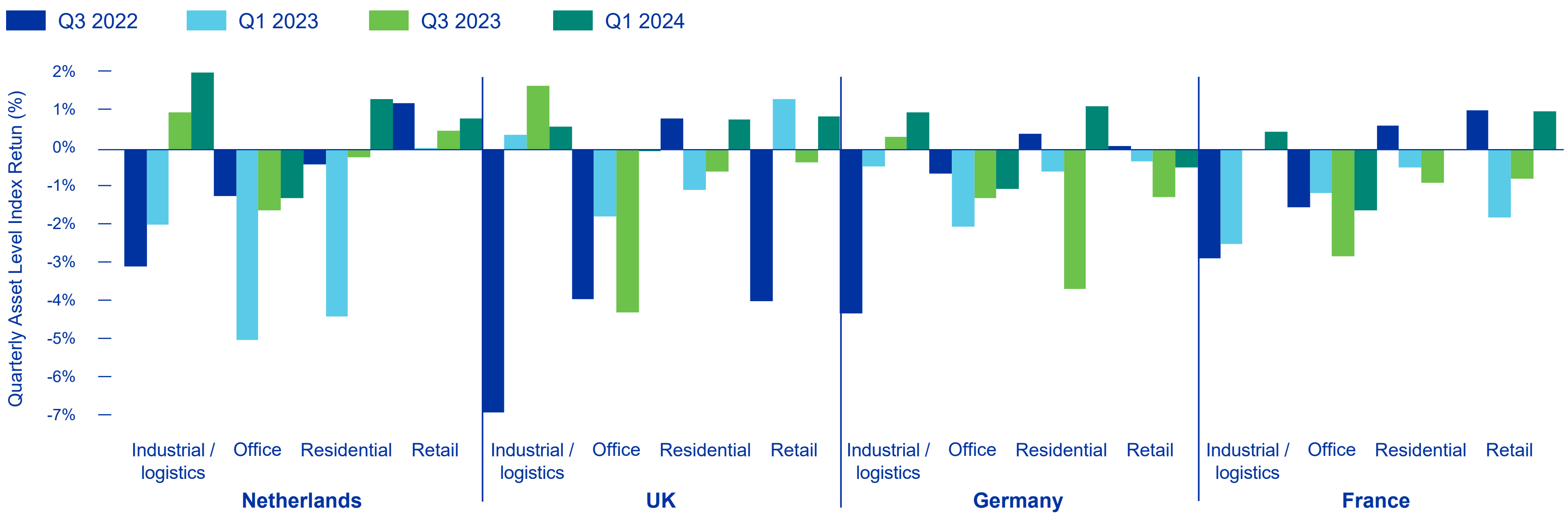
The Q1 Dutch performance was driven by industrial/logistics assets at 1.98% (+276 bps q-on-q), followed by a 1.30% return from the residential portfolio. At 0.80%, Dutch retail assets enjoyed the fifth consecutive quarter of positive performance.

The UK ranked second for the second consecutive quarter, driven by the performance of retail and residential assets at 0.83% and 0.77%, respectively. This is a change from its usual industrial/logistics-led performance, which lagged a little, at 0.59% in Q1.

Germany and France saw more nuanced Q1 results after severe downward adjustments in Q4 2023. German residential assets led with a 1.10% return, followed by industrial/logistics at 0.94%, a notable 392 bps q-on-q increase. For the first time since Q3 2022, France's best-performing sector was retail at 0.98% (+786 bps q-on-q).

European office assets saw a significant improvement in Q1 2024, albeit affected by seasonal and valuation effects, with a total return of -0.88%. This is a 369 bps q-on-q increase after a sharp correction and record low performance of -4.53% in Q4 2023. Offices is the only main sector to continue recording a negative performance at the start of 2024.

Figure 3: Performance of European real estate assets by country and sector



Source: INREV European Quarterly Asset Level Index, Q1 2024

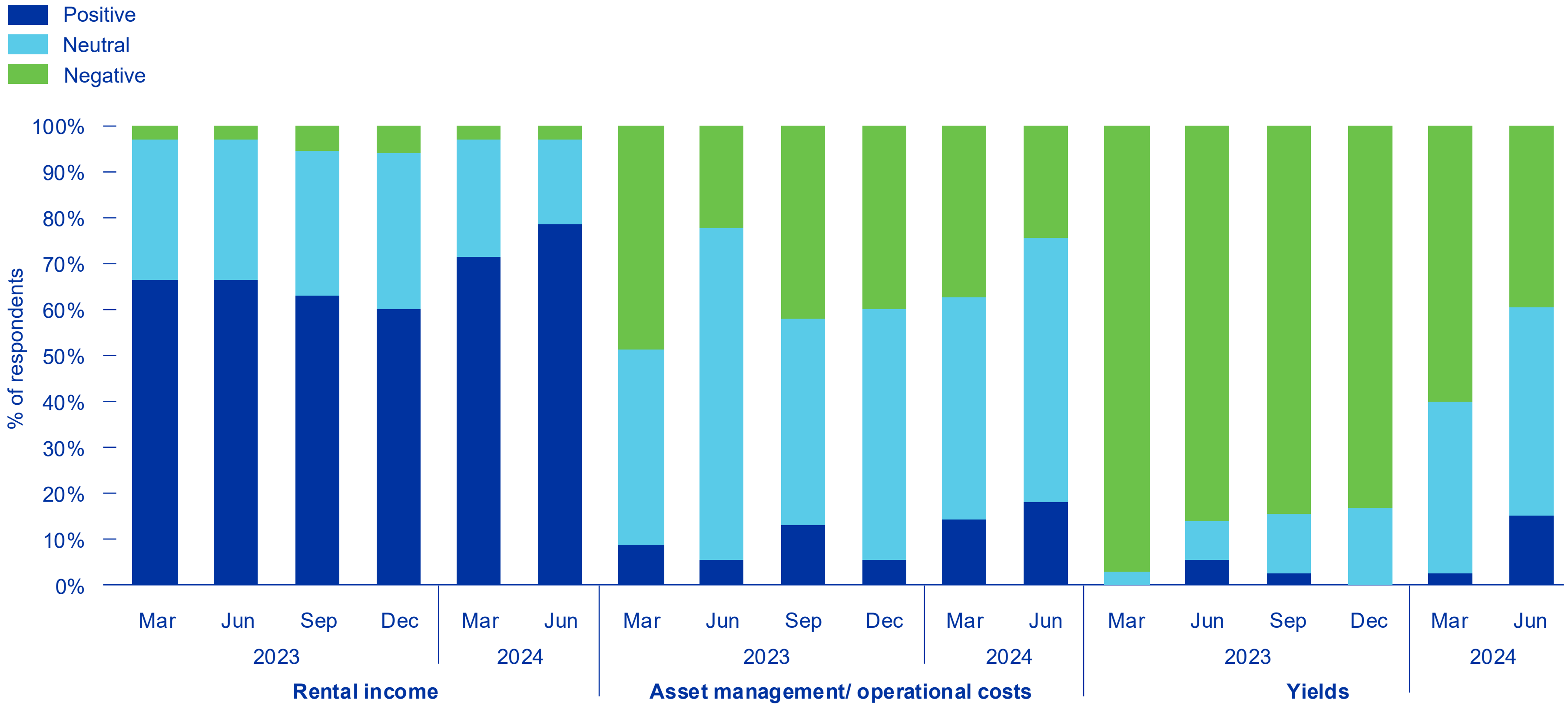
Occupier markets hold well

As of June 2024, 79% of the survey participants expect income return to be the key driver of short-term performance, the highest share since the start of the series in March 2022.

Participants have a realistic view of the current state of the market and a return to fundamentals as the era of low yields driven by artificially low interest rates is over. This is reflected in 39% of participants expecting further outward yield shifts, far higher than the minority 15% who believe yield compression is likely in Q3 2024.

The views on the impact of asset management and operating costs are mixed. Indeed, on a net basis, 6% of participants anticipate asset management and operational costs to negatively impact the Q3 2024 performance. However, 18% believe this driver will have a positive impact, the highest share since the monitoring began in March 2023.

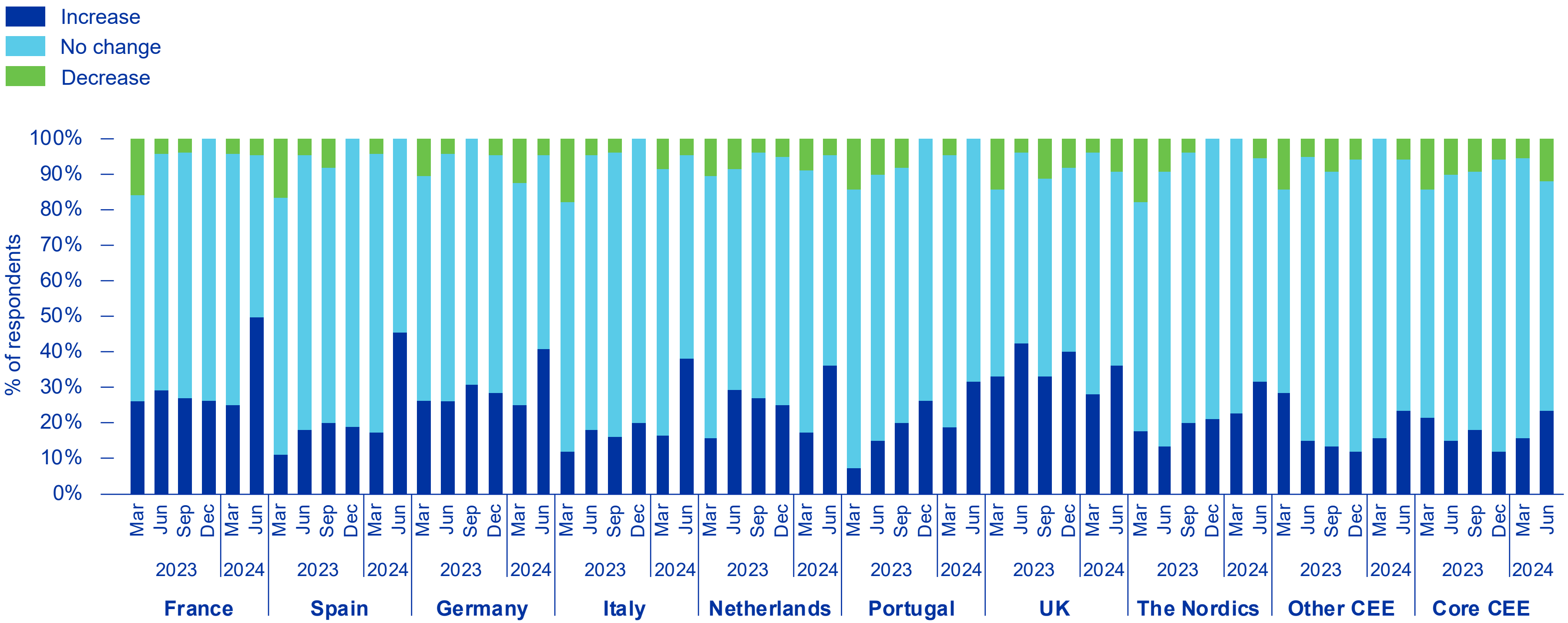
Figure 4: Drivers impact on next quarter's performance



Source: INREV Consensus Indicator Survey, 2024

The improved economic outlook and constrained supply of quality assets continue to reinforce net effective rental growth among participating organisations. Net rent increases have been reported in all markets, with France and Spain showing particularly strong increases in June 2024, in both cases revealing net positive positions of above 45% (see Figure 5). Nevertheless, the falling rents are also evident, although the share of participants highlighting a negative trend remains a minority. This is something to watch carefully as the gap between the best assets and the rest is expected to increase over time (see p.6 for further details).

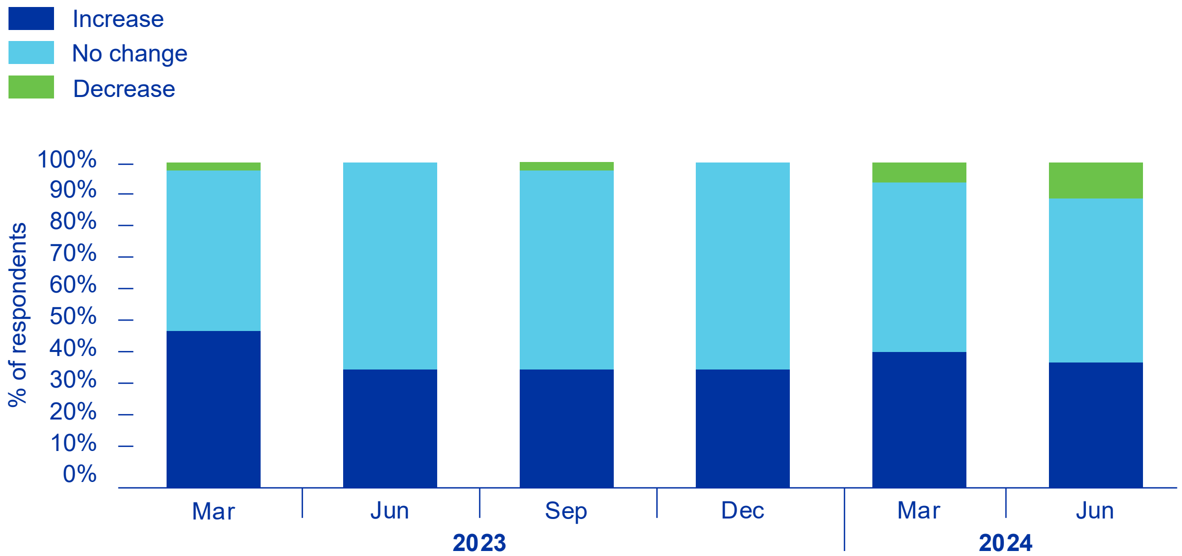
Figure 5: Change in net effective rent for new leases/lease renewals - by country



Source: INREV Consensus Indicator Survey, 2024

That said, there is a gradual increase in the proportion of participants highlighting a declining occupancy, coming in at 11.1% for June. This is a notable increase compared to the 7% reported in March and significantly higher than the results for 2023 (close to no declines).

Figure 6: Quarterly change in financial occupancy



Source: INREV Consensus Indicator Survey, 2024

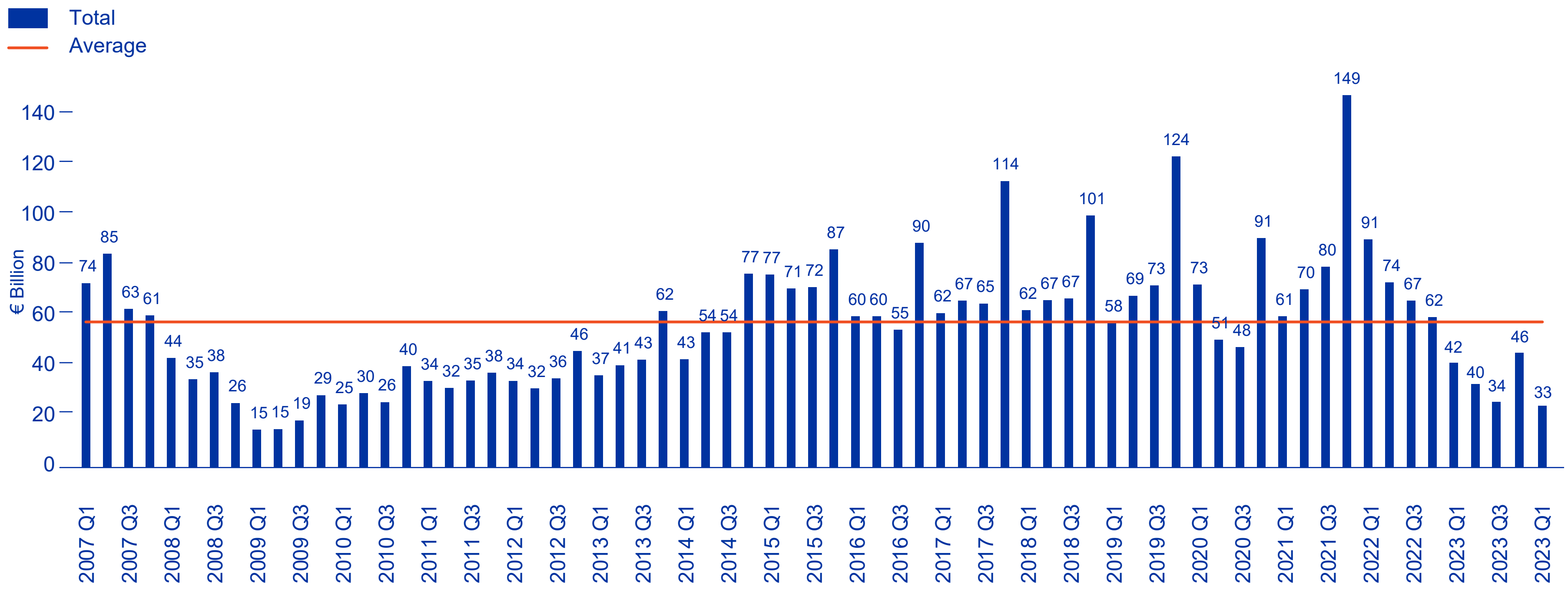
European transaction volumes decline, but the near-term sentiment improves

European transaction volumes have decreased from €46 billion in Q4 2023 to €33 billion in Q1 2024, albeit end of the year transactions volumes are usually quite high. The Q1 2024 transaction volumes remained below the long-term quarterly average of €57.2 billion, but a slight uptick in sentiment is likely to come through as the year progresses. Although discussions around deal-making are taking place, the actual transaction activity is yet to pick up.

The June INREV Consensus Indicator shows that the Investment Liquidity subindicator rose significantly to 54.1, up from 46.2 in March 2024. This signals a notable shift in sentiment, with the investment liquidity subindicator moving above 50 for the first time since inception in March 2023.

While there are early suggestions that the gap between the buyers' and sellers' pricing is narrowing, the market is not quite there yet, and might not be for another quarter or two, but the latest sentiment results are promising.

Figure 7: Transaction volumes for European estate by sector



Source: MSCI Real Assets, June 2024

Global ODCE: European ODCE funds deliver healthy income return in a revalued market

The Q1 2024 Global ODCE Fund Consultation Index sheds light on significant repricing witnessed across the globe over the past two years. For the European ODCE funds, current price levels have dropped below the 2016 levels, contrasting with other regions where prices remain above the levels recorded at the Index's inception. Despite reporting negative returns this quarter, both Europe and the US saw a quarter-on-quarter increase in performance. Europe outperformed the other regions, reporting an improvement of 377 bps with a total return of -0.56%. The US ODCE funds reported a total return of -2.58%, up 242 bps from Q4 2023.

The downward adjustment in European pricing reflects the speed of corrections in the region and should serve as a sign that the return of positive performance is near. In fact, reflective of declining capital values, the one-year rolling income return for European ODCE funds is robust, standing at 3.23%. This underscores the attractiveness of European ODCE funds for investors seeking steady returns in a revalued market.

Figure 8: Capital growth index

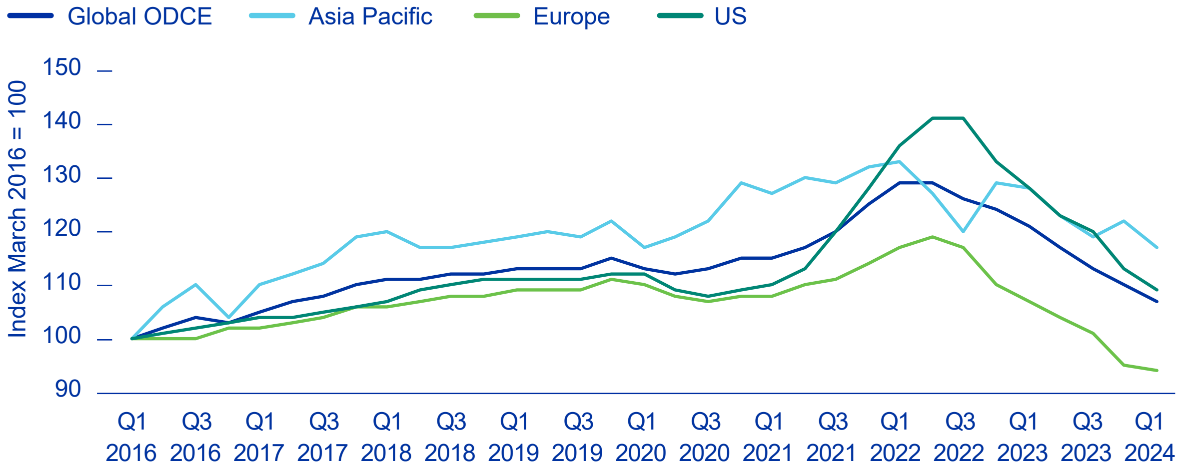
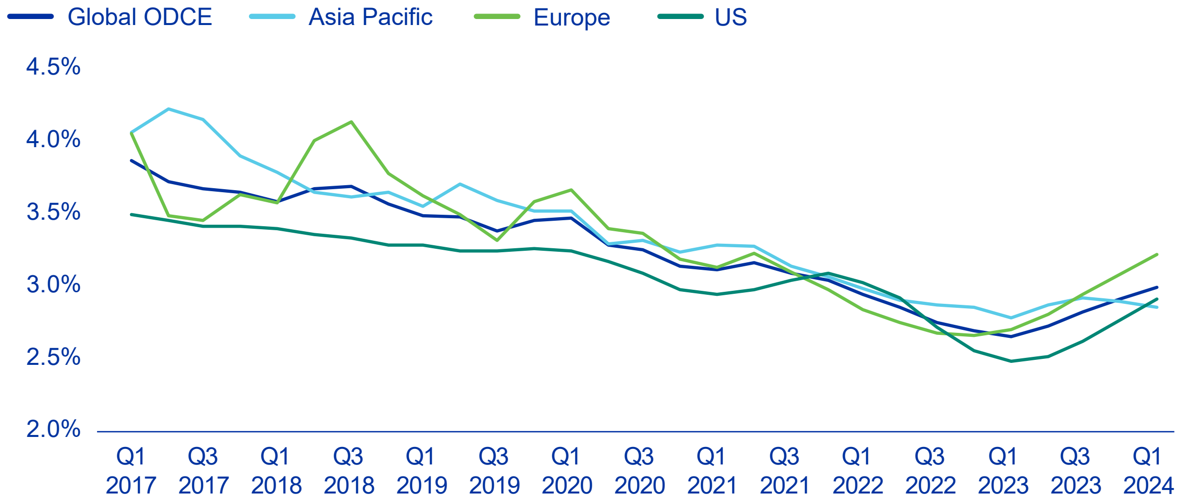


Figure 9: One-year rolling income return



Source: Global ODCE Fund Consultation Index Q1 2024

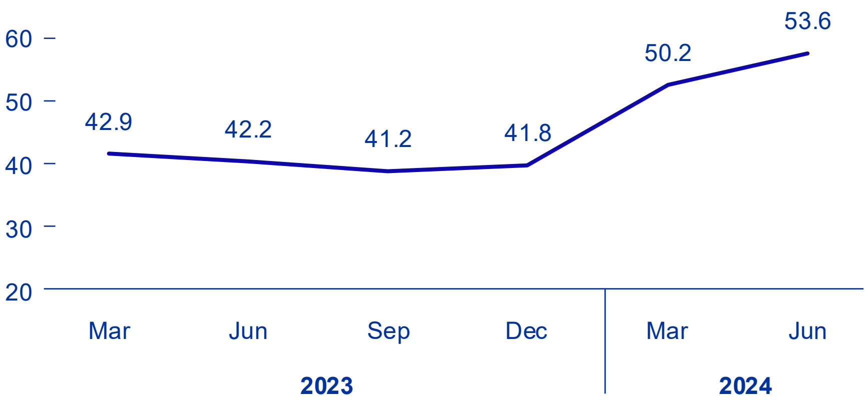
June INREV Consensus Indicator reveals second consecutive improvement

At 53.6, the June INREV Consensus Indicator reveals a notable increase from the 50.2 reported in March. This is a second consecutive improvement, suggesting the beginning of the European non-listed real estate market recovery is near.

All five subindicators improved since March, with the exception of leasing and operations, which declined from 60.2 in March to 58.9 in June. This decline is attributable to a slight retraction in the growth of effective rents and occupancy rates, although both metrics remain net positive. It remains the strongest subindicator but highlights the growing bifurcation in the occupier markets. Close to 15% of aggregate portfolios experienced a decline in rents this quarter, against 56% with an overall improvement.

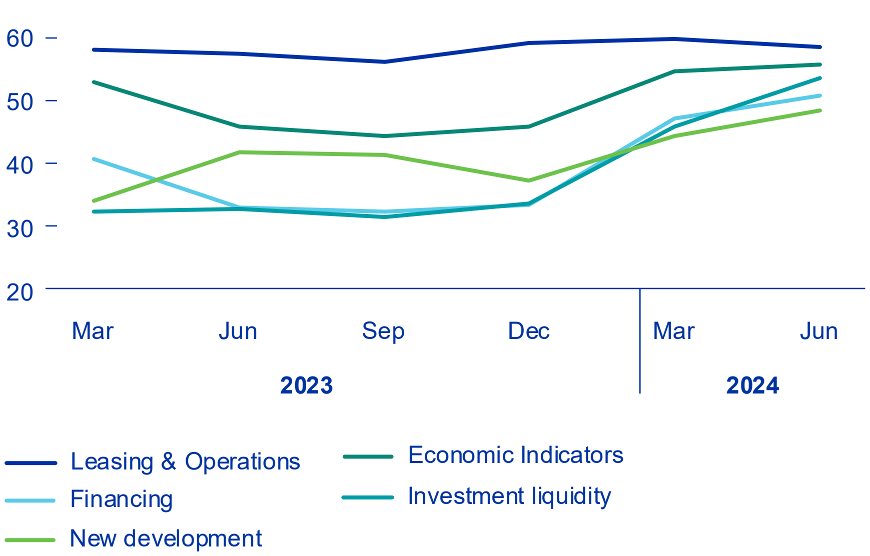
As mentioned earlier, the economic subindicator increased to 56.1 in June 2024. This is a marked increase from the 46.3 recorded in June of last year. Four out of the five subindicators now exceed 50, with new development being the only subindicator below the 50 mark, at 48.9.

Figure 10: INREV Consensus Indicator



Source: INREV Consensus Indicator, 2024

Figure 11: INREV Consensus subindicators



Source: INREV Consensus Indicator, 2024

Most geographies display positive sentiment in H1 2024

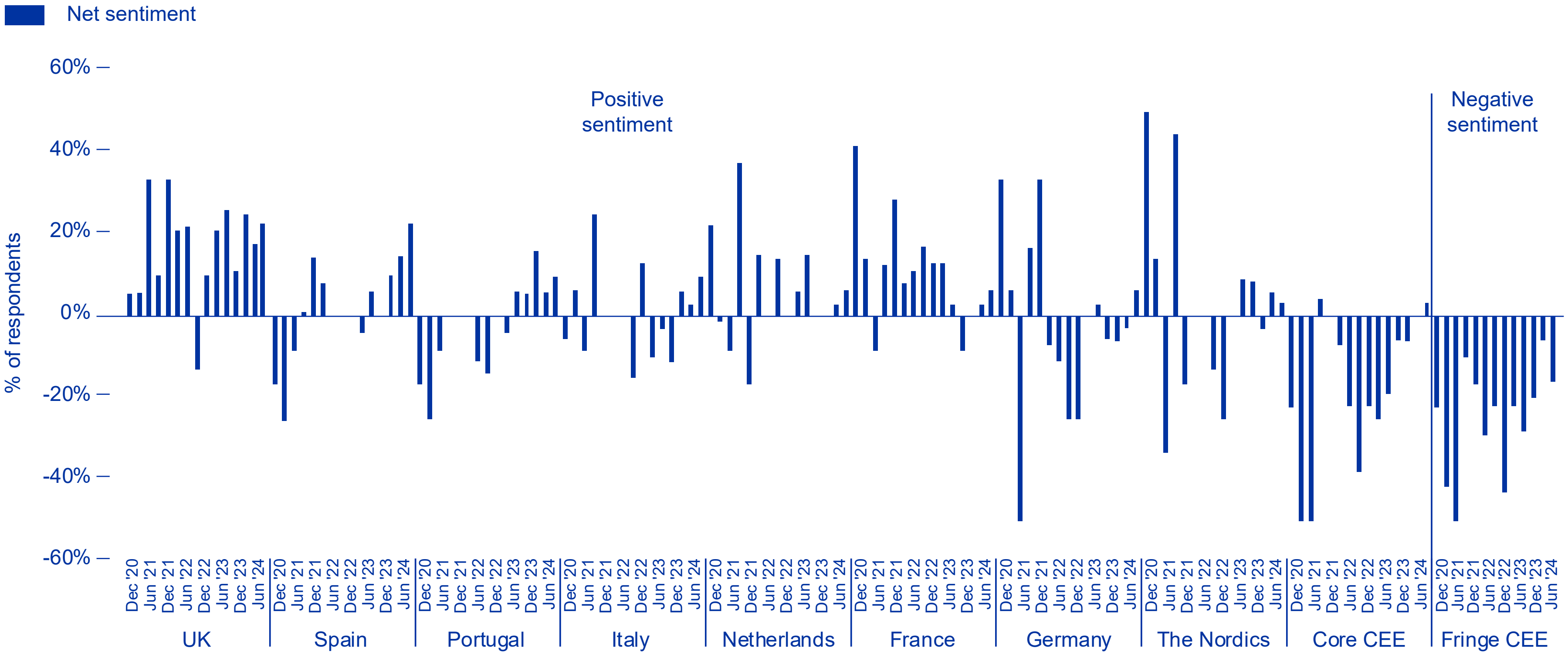
The latest results reveal a positive shift in sentiment for most countries in the first half of 2024. Germany emerges from three consecutive quarters in negative territory, with a net 6% share of participants expressing their intention to increase their German investments, from -3% in March.

Similarly, Core CEE reported a cautious net positive sentiment of 3%, reversing nine quarters of net negative position. Only the Nordics and Fringe CEE witnessed a decline in the net share of participants seeking to increase their weightings in Q2 2024.

At the opposite end, the UK remains the most preferred investment destination, with a net increase position of 23%. This time it is joined by Spain with an equal share of participants.

Rising from 15% in March, Spain's position solidifies its appeal, supported by a stronger economic outlook and higher yields relative to most European markets. Other Southern European countries, such as Italy and Portugal, reported moderate positive sentiment, both at 10%. France and the Netherlands followed, both reporting 6% in the net positive.

Figure 12: NNet sentiment towards European real estate by geography



Source: INREV Consensus Indicator Survey, June 2024

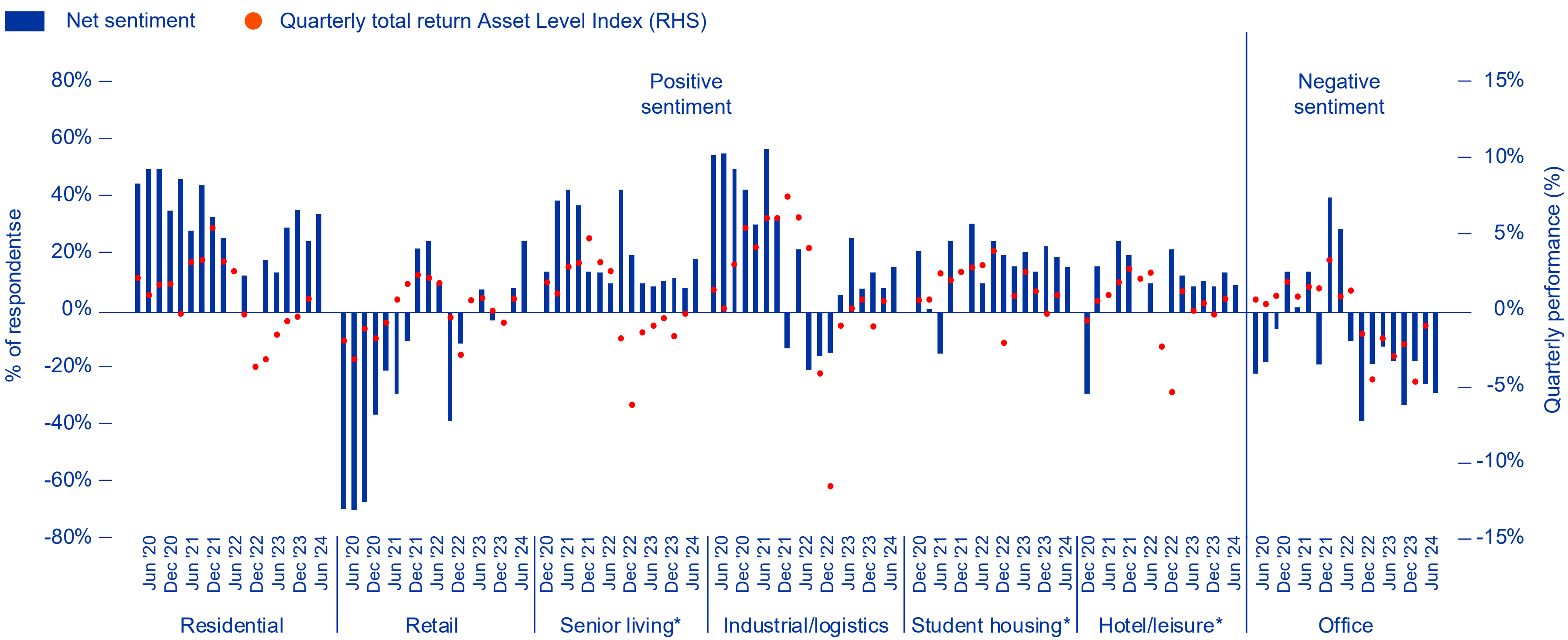
Retail sector's sentiment climbs back up

As of June 2024, residential remains the top preferred sector capturing 34% net interest, a 9% increase since March. Notably, 25% of participants now plan to boost their retail allocations, a significant rise from 8% in March and 0% in December 2023. This shift aligns with the latest INREV Asset Level Index results, which show retail assets performing comparably to residential, with a Q1 return of 0.88%. Retail assets now have the highest one-year rolling return among the four main sectors, at 1.09%.

Other living sectors, namely senior living and student housing, both remained in the net favourable territory with 19% and 16% of participants looking to increase their allocations, respectively. Industrial logistics also stayed in the net positive sentiment, at 16%, a notable improvement on the net 8% in March.

Hotel/leisure and office sectors both witnessed a slight decline in sentiment, albeit only office remains in deep negative territory, falling from -25% in March to -28% in June 2024. This continuous downturn is unsurprising, given the office sector's ongoing challenges, culminating in its lowest performance since inception at 2023-year end with an asset level Q4 2023 return of -4.57%. Consequently, the one-year equivalent rolling return for offices stood at -10.07% in Q1 2024.

Figure 13: Sentiment and performance by sector



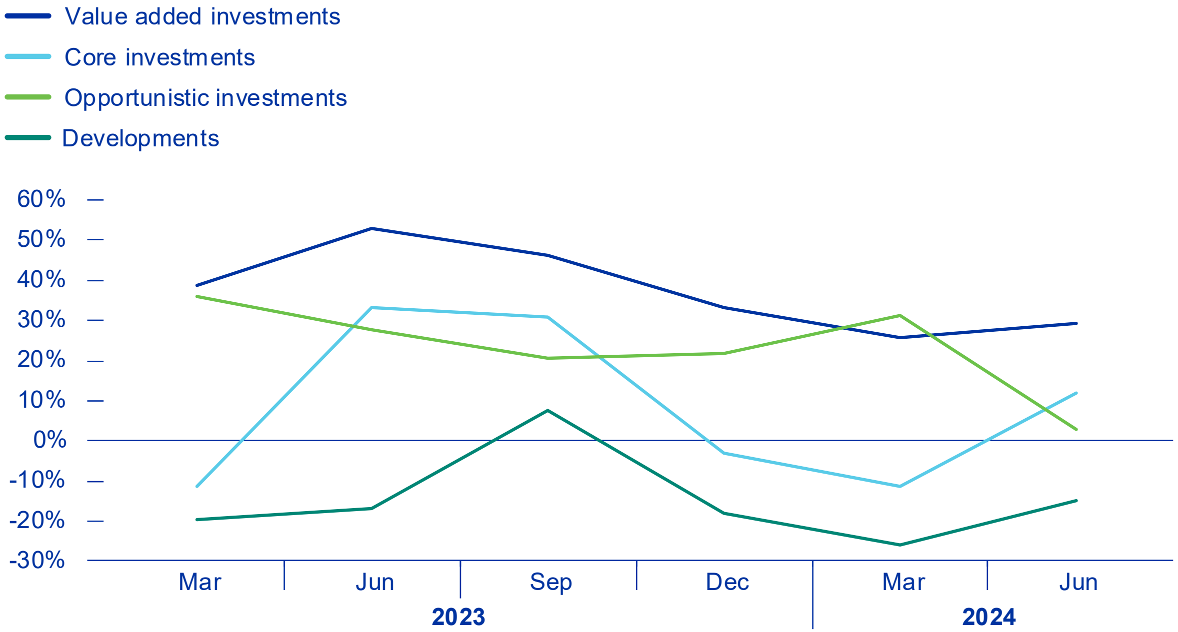
Source: INREV Consensus Indicator Survey, June 2024

Shifting preference towards core, but value added investments are most favoured

Value added investments continue to be highly attractive, maintaining a strong preference as an investment style, while core investments have seen a significant shift, moving up in preference from a negative view in March 2024 (-11.4%) to a positive 11.8% attractiveness rating in June. This change is likely driven by significant repricing levels, making market participants consider core strategies again as they seek stability and lower risk amid ongoing economic uncertainties.

Conversely, opportunistic investments have experienced a considerable decline in attractiveness over the same period, just remaining in the positive sentiment.

Figure 14: European real estate: change in percieved attractiveness of investment styles



Source: INREV Consensus Indicator Survey 2024

Performance outlook improves further while assessment of risk continues to diminish

Encouraging numbers emerge from the June 2024 results, where the net view on European real estate performance increases for the second quarter in a row. Now, 30% of participants express a further improvement in outlook (see Figure 15).

In parallel, the perception of investment risks has decreased significantly, down by 30% on a net basis (see Figure 16). These results mark a stark contrast to the negative sentiment prevalent throughout 2023.

Figure 15: View on European real estate performance

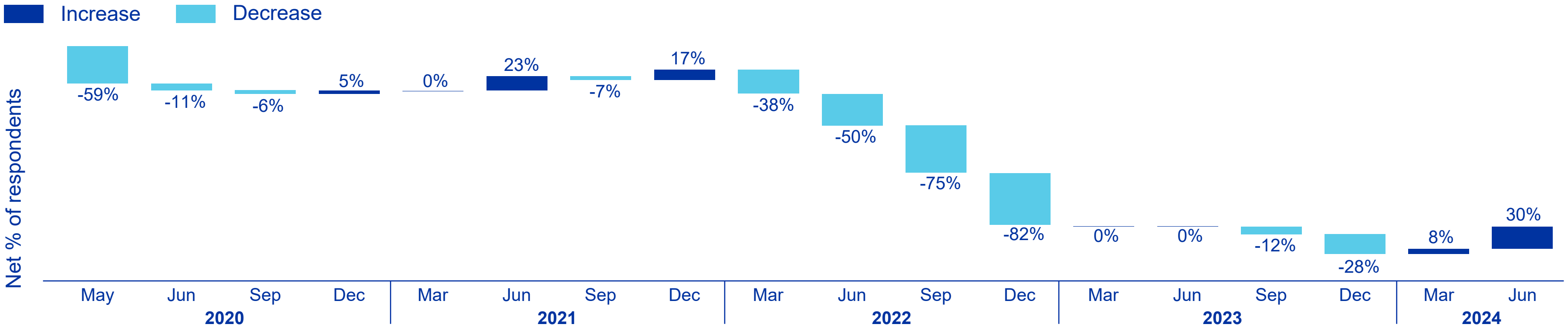
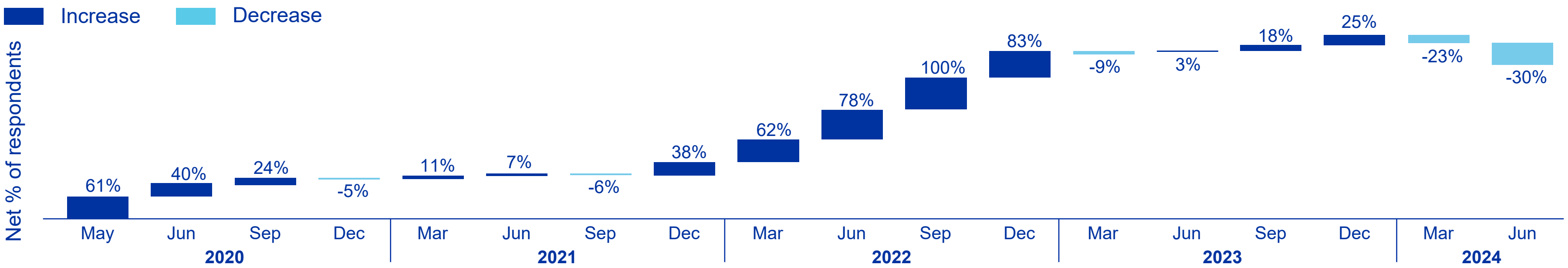


Figure 16: Assessment of investment risk for European real estate



Source: INREV Consensus Indicator Survey, 2024

This update highlights the latest results from the INREV European Quarterly Asset Level Index Q1 2024, INREV Quarterly Fund Index Q1 2024, INREV Valuations Survey Q1 2024 and INREV Consensus Indicator June 2024 to illustrate the impact on market performance, investment plans and operations.