European Commercial – Q3 2024

SPOTLIGHT
Savills Research

European Investment
The silver lining

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The calm before the growth

September 2024 brought forth a wave of economic indicators that signalled continued deceleration in the European economies. In the Eurozone, economic growth slowed to a modest 0.2% in Q3 2024, underscoring the region's broader economic struggles. Capital Economics projects a similarly weak growth of 0.2% for Q4 2024, reflecting softer industrial output and subdued consumer spending across key European economies. In 2025, the eurozone GDP is expected to grow, albeit at a slow pace, with Capital Economics projecting a 1% increase.

Inflation across the Eurozone dropped to 1.8% in September, down from higher levels earlier in the year. The decline was largely driven by a slowdown in services inflation, which had consistently stayed above the 4% mark for most of 2024. On the monetary front, following the 50 basis point interest rate cut by the US Federal Reserve, attention has shifted towards the European Central Bank. Analysts from Capital Economics anticipate that the ECB will follow a more accommodative policy, potentially cutting interest rates by 25 basis points at each meeting from now until March 2025. This would bring rates down from 3.50% to 2.50% by next year, reflecting concerns over the fragile growth outlook.

Turning tides within the investment market

In this context, the European investment market showed a mixed picture in the third quarter of the year. While July and August saw disappointingly low levels of activity, leading to subdued investment volumes, there are increasing signs of an imminent recovery.

Preliminary results suggest that investment volumes in Q3 will likely reach €37.1 billion, reflecting a 6% decline compared to the previous quarter but a 15% increase from the same period last year. This brings the total investment volume for the year to €113.3 billion, a 5% rise on last year, though still 41% below the five-year Q1-to-Q3 average.

Certain regions are recovering more rapidly than others. Southern Europe and Central and Eastern Europe (CEE) have shown particular resilience. In Southern Europe, investment volumes are expected to be up 11% year-on-year, although still 14% below the five-year Q1-to-Q3 average. CEE volumes have risen 16% year-on-year but remain 32% below the five-year average. Among core markets, the UK is rebounding strongly with a 26% year-on-year increase, though still 19% below the five-year average. In contrast, Germany and France are lagging behind, with Germany hindered by low GDP growth and France affected by election-related uncertainty.

Despite these modest figures, the market shows signs of increasing activity, particularly since the beginning of September. A key boost came on 12th September, when the European Central Bank's decision to cut interest rates positively impacted market sentiment across the Eurozone. Since then, investor interest has been growing, supported by improving pricing conditions and an increasing number of assets coming to market. Sellers, particularly European open-ended funds under pressure to meet redemption requests, are being forced to offload assets to generate liquidity. As a result, deal activity is accelerating, with larger transactions becoming more common due to easing conditions on bank loans. Further supporting the recovery momentum, a wider range of investors, notably institutional investors, is re-entering the market, as some markets start to see accretive returns to debt financing.

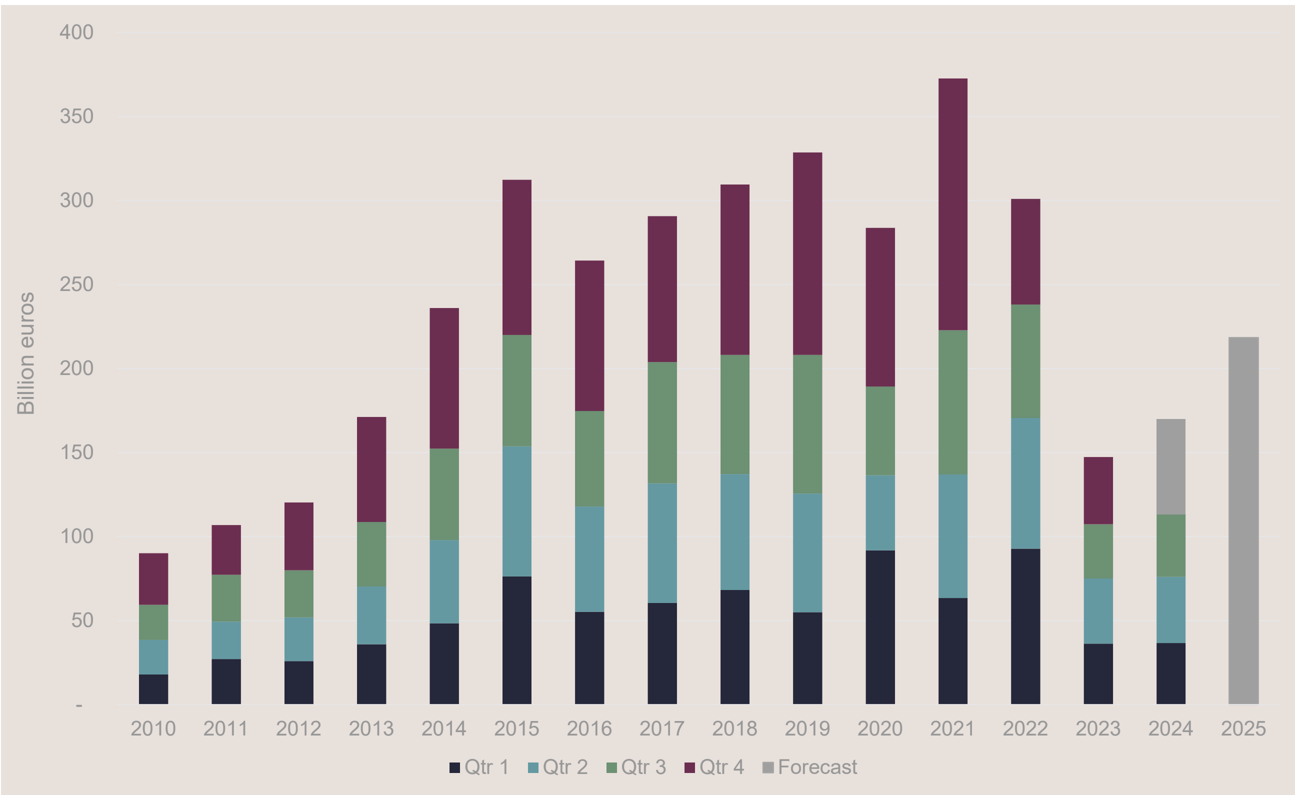
Consequently, we anticipate that total investment in Europe will reach around €170 billion by the end of 2024, a 15% increase on the previous year. This trend is expected to continue into 2025, with investments potentially reaching €219 billion, representing 29% year-on-year growth. The recovery is expected to spread across most European markets as buyer and seller expectations gradually align. However, Germany and France may continue to lag behind for another six months. Cross-border investment flows are predicted to rise, driven by a resurgence in intra-European investments and capital from the United States. German, Israeli, French SCPI, and Spanish investors are likely to remain active, particularly in acquiring office assets in Western Europe. US private equity firms, which have focused on offices in London and Dublin, may begin exploring other locations where rental growth and yield improvements are anticipated.

Hence, the office market is expected to gradually recover next year, attracting core and core-plus investors targeting super-prime and green-certified properties. Meanwhile, the logistics and hospitality sectors will continue to attract significant capital in 2024 and 2025. Interest in retail assets, particularly shopping centres, is also expected to rise, as they remain among the most competitive asset classes. However, low-yielding sectors such as multifamily is expected to face trading challenges through the end of this year, with recovery likely in 2025.

Looking ahead, diversification strategies are expected to intensify as investors seek to avoid overexposure to specific sectors. In the longer term, all asset classes stand to benefit from the overall market recovery. Next year, we anticipate increased interest in secondary assets, with strategies focusing on revaluation, repurposing, and repositioning to meet ESG standards.

During the third quarter, European average yields remained mostly stable, with some inward yield shifts in some prime logistics and CBD office markets, indicating that prices may be starting to bottom out. Over the next six months, yields are expected to stay steady across Europe, with more noticeable compression anticipated for logistics assets and, to a lesser extent, retail parks. In contrast, shopping centres could see a slight rise in yields. Starting from the second quarter of next year, we anticipate prime yield compression to spread across various asset classes and European markets.

European investment volumes



Source: Savills Research

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