

Market Insights on European non-listed real estate in December 2023

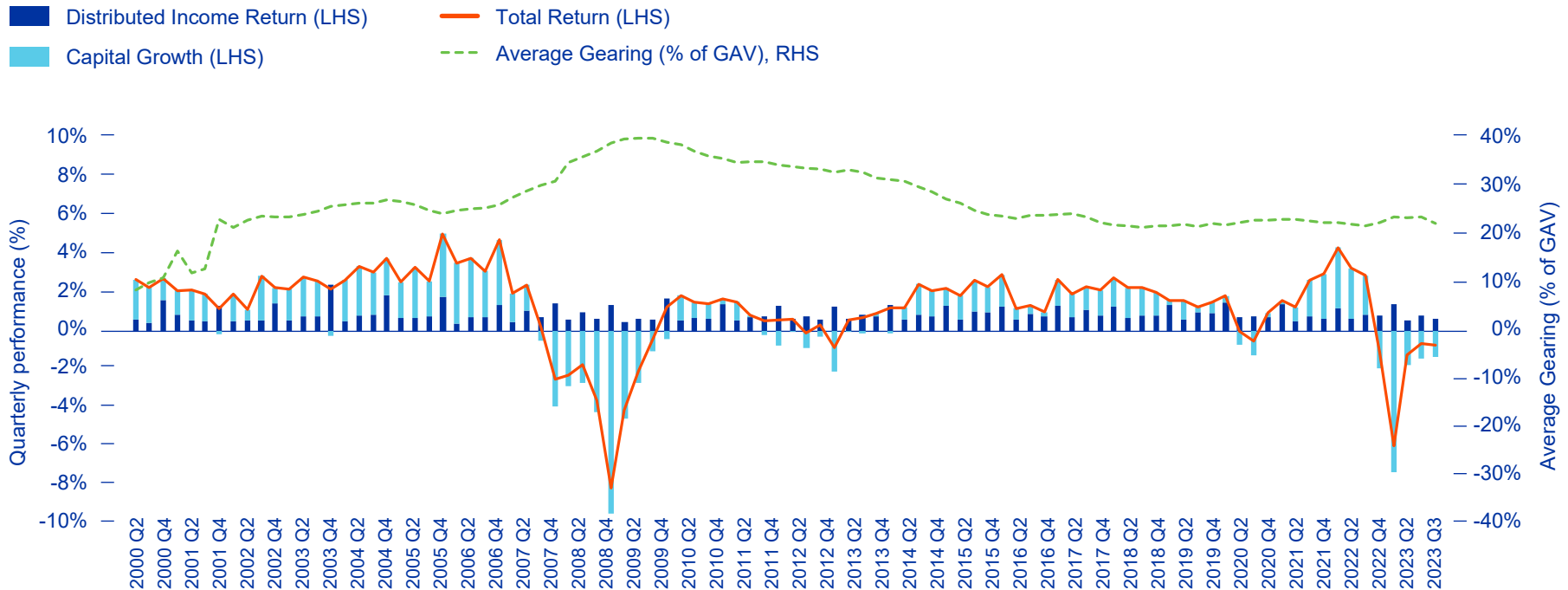
The latest edition of the INREV Market Insights reveals that the correction in European real estate continued in the third quarter of 2023, with the INREV Fund Index delivering a total return of -0.72%. While distributed income return declined slightly to 0.63%, capital growth of -1.35% was

the main driver of performance. It is the fifth consecutive quarter of negative capital growth, bringing the total correction in pricing since the end of Q2 2022 to -13.15%.

INREV's new Consensus Indicator reveals an equally subdued picture, with the December

headline reading of 40.8. A Consensus Indicator of under 50 indicates negative sentiment, marking 2023 as a year of contraction as the headline results remain below 50 since we started to track the market consensus in March 2023 (see p.7 for more details).

Figure 1: European non-listed real estate performance



French and German assets correct the most in Q3

Significant dispersion exists across markets and sectors in terms of the magnitude of correction. While all main countries delivered negative performance in Q3 2023, France and Germany registered the lowest total returns of -1.40% and -1.08%, respectively. To a great extent, this is due to the lag in valuations relative to other markets, especially the UK, where more substantial markdowns on property values have already occurred. Nevertheless, the UK and the Netherlands

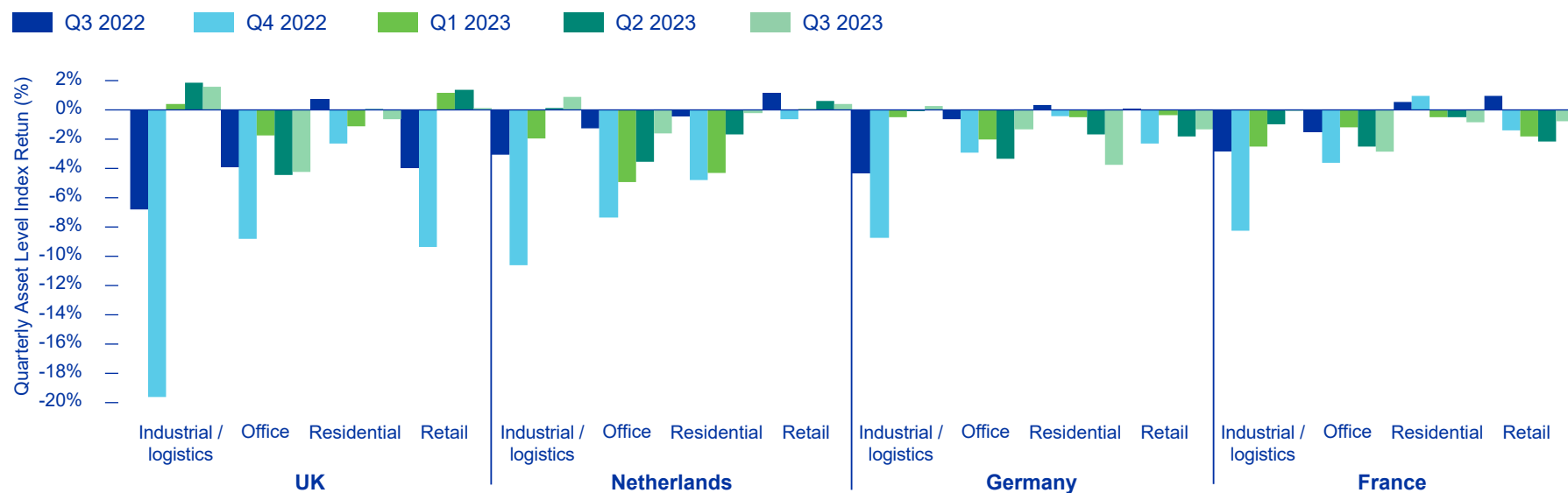
also reported negative performance in Q3, at -0.29% and -0.12%, respectively. [‘The European real estate valuations: understanding and interpreting results’](#) paper explains the underlying causes of differences in the degree of valuation smoothing across European non-listed real estate market.

The picture in terms of sectors looks different. Office assets continue on a sharp persistent correction with a total Q3 return of -2.13% and a five-quarter aggregated capital value decline of 16.36%. It remains the worst-performing sector for the second quarter in a row. Office

fundamentals remain weak with hybrid working still in full effect, albeit the letting market reveals more of a mixed bag (see p.8 for more details).

The industrial/logistics sector is at the other end of the scale, with a second quarter of positive total returns, it is outperforming all other sectors by a notable margin. The Q3 industrial/logistics assets returned 0.81%, the best result since Q2 2022. Retail and residential assets’ performance came somewhere in between, with total Q3 returns of 0.22% and -0.56%, respectively.

Figure 2: Performance of European real estate assets by country and sector



Sector and country allocations drive down the latest performance of the European ODCE Index

The INREV Quarterly Fund Index's and European ODCE Index's performances tracked each other relatively closely in most quarters since the ODCE data series began in Q3 2011. Over the Q3 2011 to Q1 2023 period, the average quarterly difference between the two was 18 bps. The Q2 and Q3 2023 returns reveal a larger gap, with the European ODCE Index underperforming the INREV Fund Index by 131 bps and 183 bps, respectively. Apart from the natural differences in the composition of the indices, geographic and sector allocations are also a big driver.

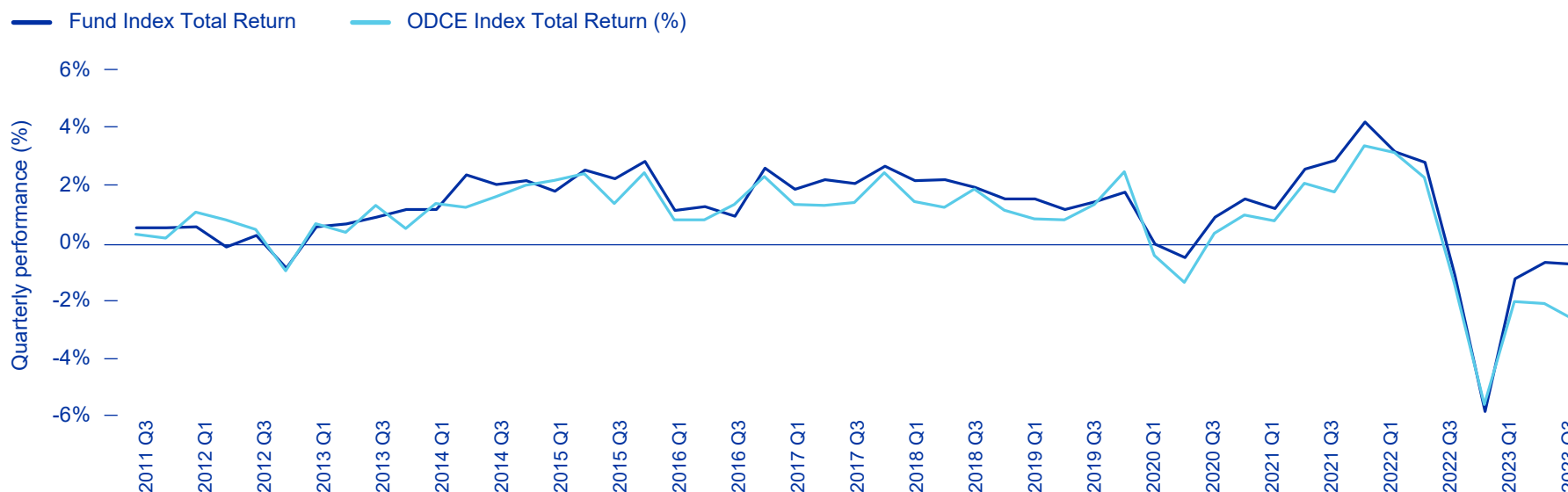
As geographies and sectors show different trajectories of correction, and in some cases an early recovery, this is affecting the latest quarterly performances. At 20.1%, the UK forms a notable component of the INREV Fund Index, and with its Q1 and Q2 2023 performance already turning positive and a moderate Q3 declines at the time when most continental markets are showing deeper declines as valuations catch-up goes some way to explain. At the end of Q3 2023, the UK allocations in the European ODCE Index were about half as much, at 10.4%.

There is also a sectoral component. Allocations to offices are still relatively high in the ODCE Index (35.4%, down from 44.1% at

the end of 2018) relative to the INREV Fund Index's 23.7%. Strong negative performance of offices across the board, including the UK, is eroding some of the latest ODCE Index's performance. On the other hand, allocations to residential and other alternative sectors that are performing better are higher in the overall INREV Index than in the ODCE one, with 44.7% and 18.5%, respectively. Allocations to industrial/logistics are similar, with 25.3% and 31%, respectively.

The European ODCE Index performance may well revert to a much tighter and less volatile band as has been the case until only recently, but the short-term impact that the current allocations are bringing is worth highlighting.

Figure 3: European non-listed real estate performance, INREV Fund Index vs INREV ODCE Index

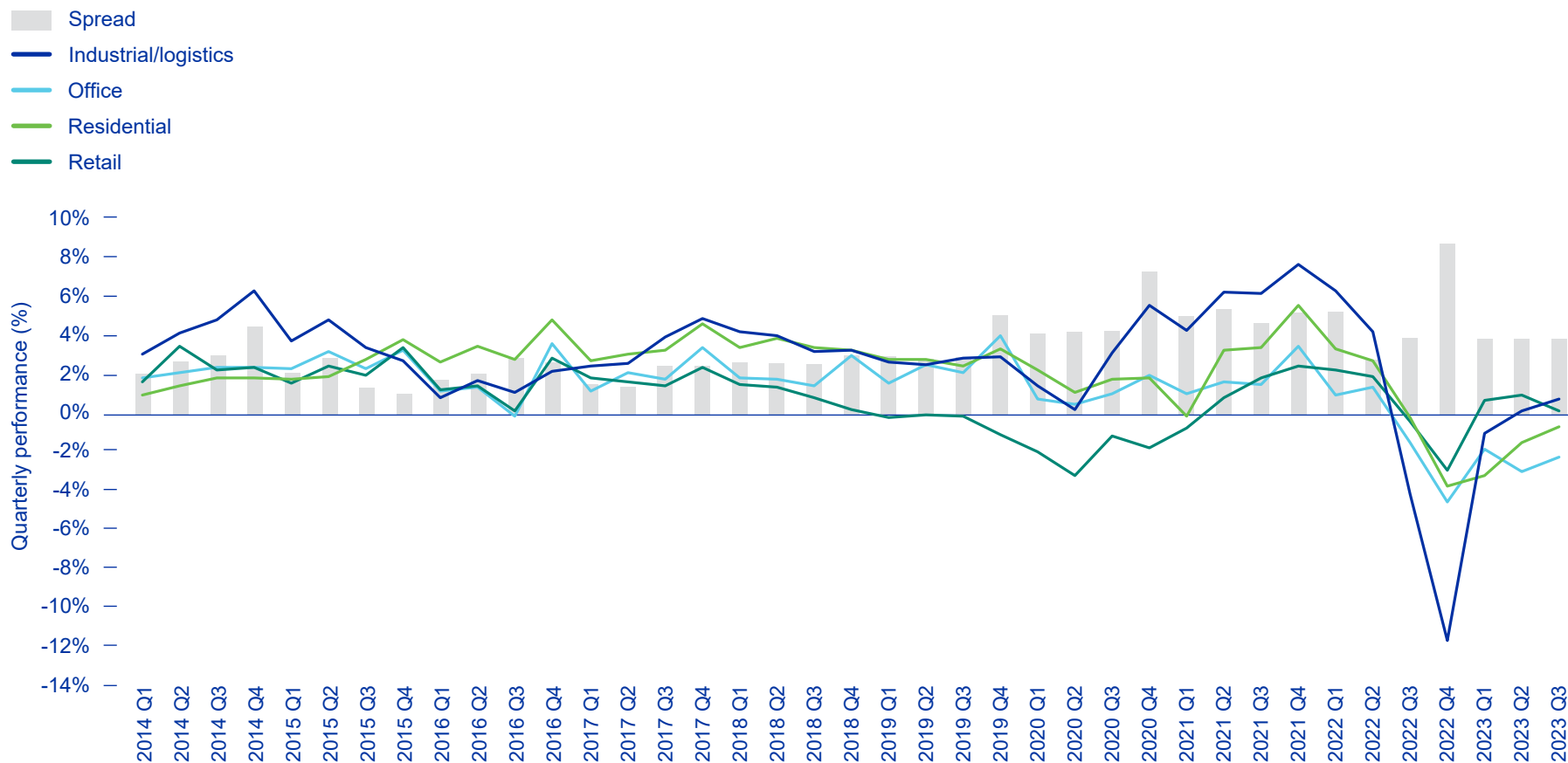


The difference in performance among the main four sectors decreased slightly to 294 bps in Q3, indicating a reduced range between the best and worst-performing sectors compared to the first half of the year

(385 bps in Q1 and 386 bps in Q2). While the performance of pan-European industrial/logistics and retail assets remains in positive territory, all other sectors are still undergoing a notable downward correction.

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Figure 4: Performance of European real estate assets by sector

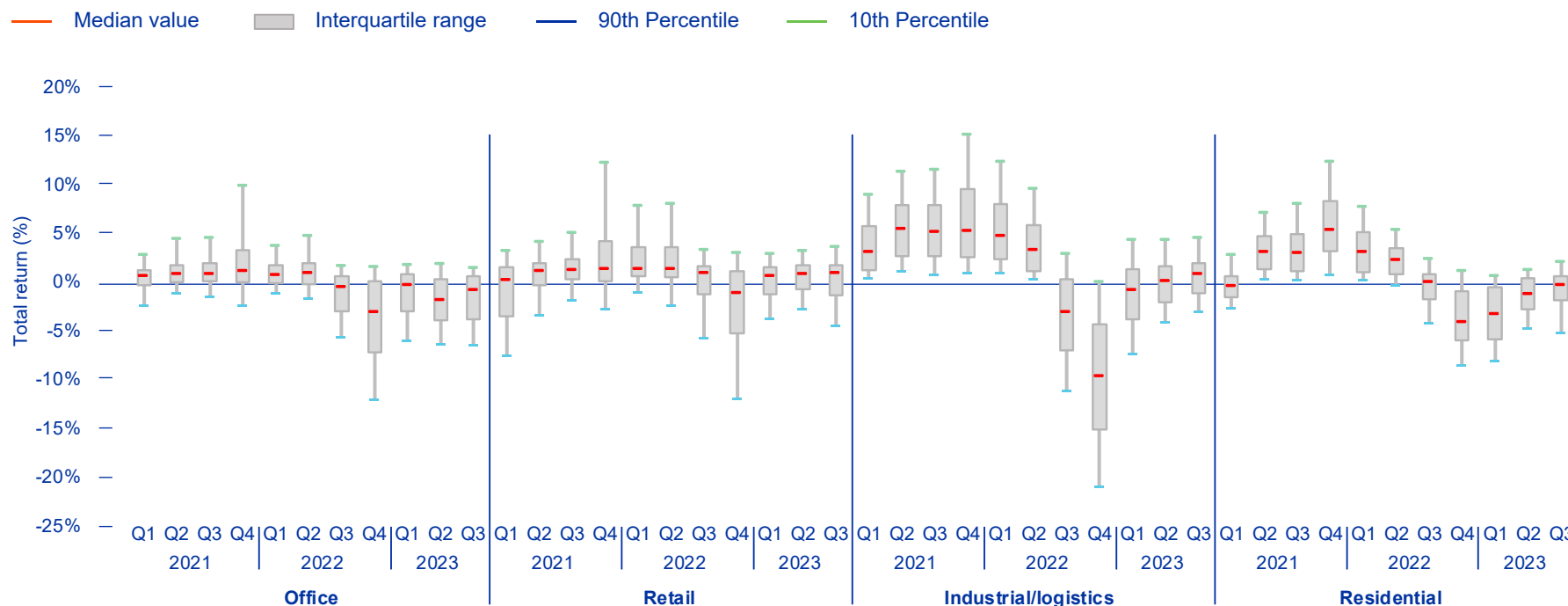


Office assets displayed the largest differences in performance among the four main sectors. The level of dispersion between its lower and upper quartile stands at 4.38% this quarter. The difference between its 10th and 90th percentile (7.94%) clearly reflects the growing bifurcation between prime and secondary assets.

Industrial/logistics and retail assets show high Q3 interquartile dispersions as well, at 3.06% for both. The results differ when turning to the percentile dispersions. The spread for retail assets is 43 bps wider than for industrial/logistics assets, with its weaker performing assets weighing heavily on a negative side.

Residential assets show significantly less dispersion, at 2.51% at the interquartile level. This is no surprise when looking at the relatively stable, income driven fundamentals, albeit the slight negative performance this quarter.

Figure 5: Performance distribution across sectors



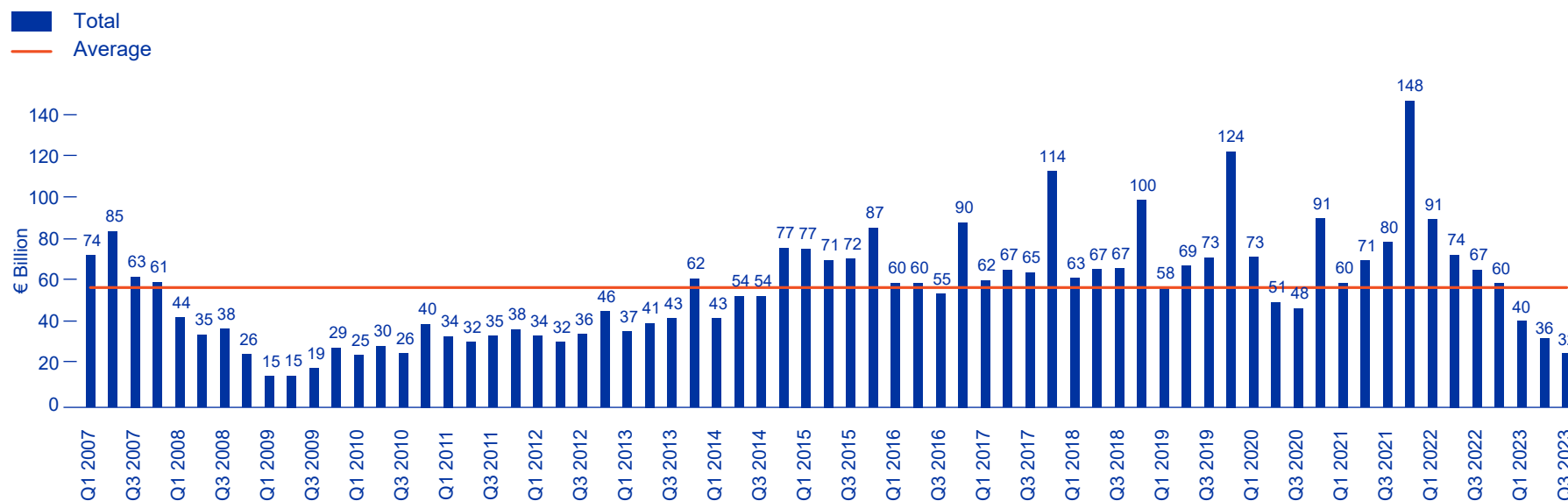
Seventh consecutive quarter of transaction volume declines

European transaction volumes have declined for the seventh consecutive quarter, reaching €31.5 billion in Q3 2023. The decline is evident across most main geographies and sectors, albeit hotels reported a slight quarter-on-quarter €0.3 billion increase in transactional activity in Q3.

The Q3 2023 pan-European transaction volume of €31.5 billion is 45.3% down on the long-term quarterly average of €57.5 billion and the longest time in history to see no rebound in investment activity. INREV Consensus Indicator confirms the negative outlook, as the investment subindicator remains the weakest, at 29.5, despite the fifth quarter of pricing corrections. Comparing with the global financial crisis when transaction

volumes shrunk to only €15.2 billion after five quarters of consecutive declines, the prolonged trajectory of the current decline clearly suggests that markets anticipate further value falls.

Figure 6: Transaction volumes for European real estate



December INREV Consensus Indicator reveals contraction across four out of five subindicators

The newly launched December INREV Consensus Indicator¹ reveals a subdued picture for European non-listed real estate.

At 40.8, the latest headline results remain firmly in the sub-50 territory, leaving little possibility of a rapid turnaround.

Four out of the five subindicators, namely economic, new development, investment liquidity and financing, remain well below 50 this December. At 29.5, the investment

liquidity subindicator is the weakest. The financing subindicator is second weakest, at 33.8. The new development subindicator fell further since September and is now at 37.9. The further away from the 50 mark the results, the greater the level of change, and this December is largely contraction.

Figure 7: INREV Consensus Indicator

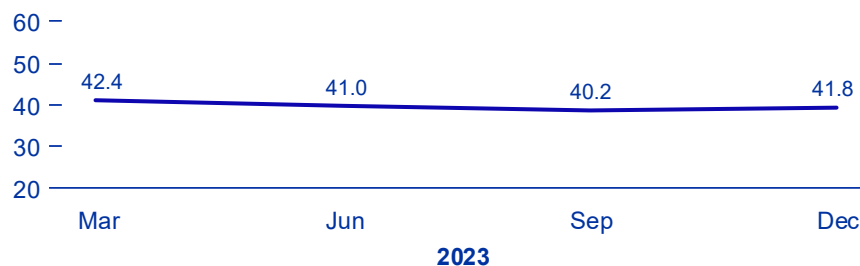
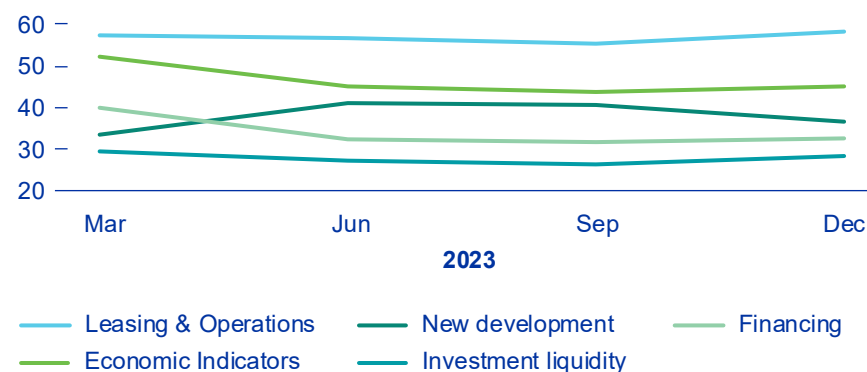


Figure 8: INREV Consensus subindicators



¹ INREV Consensus Indicator is a new diffusion index, designed to measure the direction of trends in the European non-listed real estate market. Its purpose is to provide insights to decision makers, investors, market analysts and asset allocators, and to become the leading indicator for European non-listed real estate. For more detailed insights and analysis download the [full publication](#) or visit the [Consensus Indicator page on our website](#).

Leasing and operations is the only subindicator that remains above 50, improving to 59.5 in December. The positive signs stem from the net improvement in effective rents of participating organisations' existing portfolios and higher net effective rents for new lettings (see Figure 10).

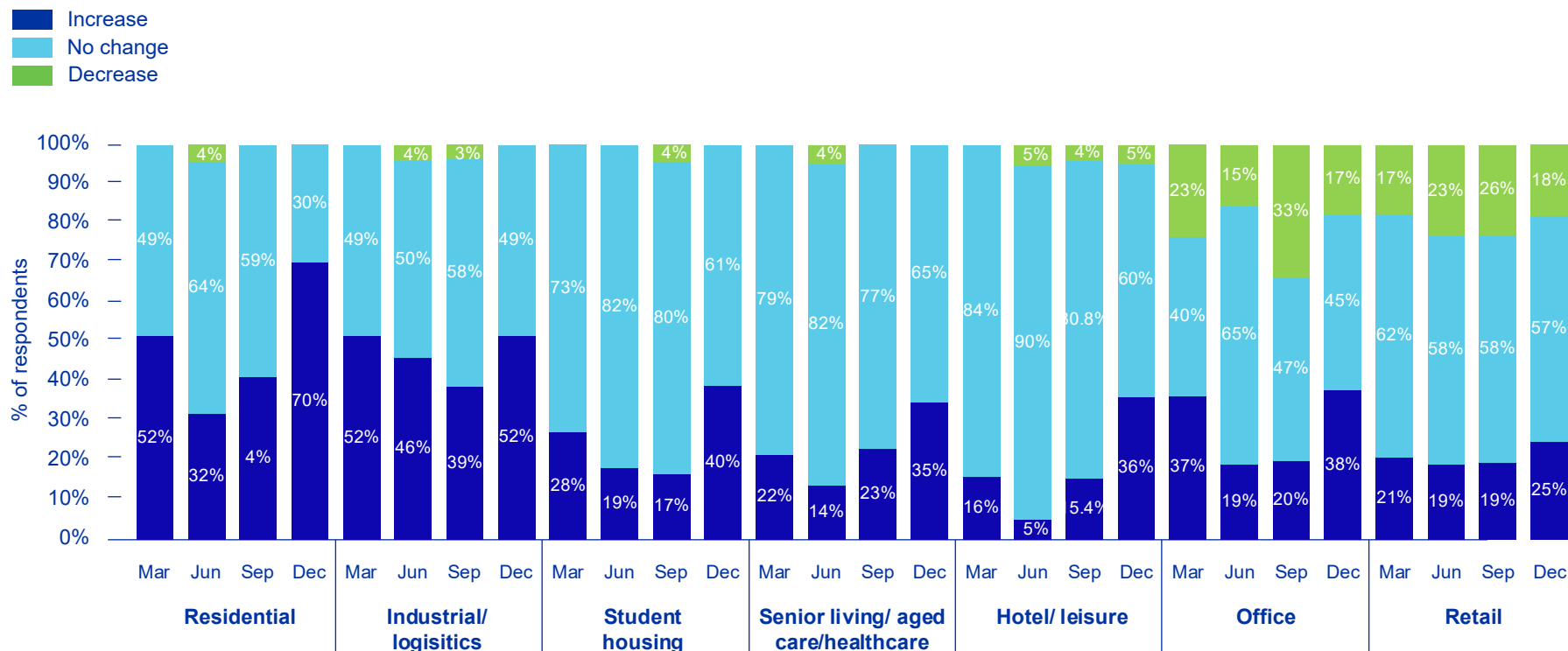
For how long and to what extent this positive trend can be maintained is unlikely to be clear until much later in 2024 or even 2025.

The latest results highlight that higher net effective rents are achieved across a notable portion of new lettings and lease renewals, especially for residential and other living sectors, as well as industrial/logistics assets.

Dependant on asset quality, office and retail lettings show distinctly different rental dynamics. It is yet another illustration of the much discussed dispersion in performance, which we only expect to exacerbate in the coming quarters.

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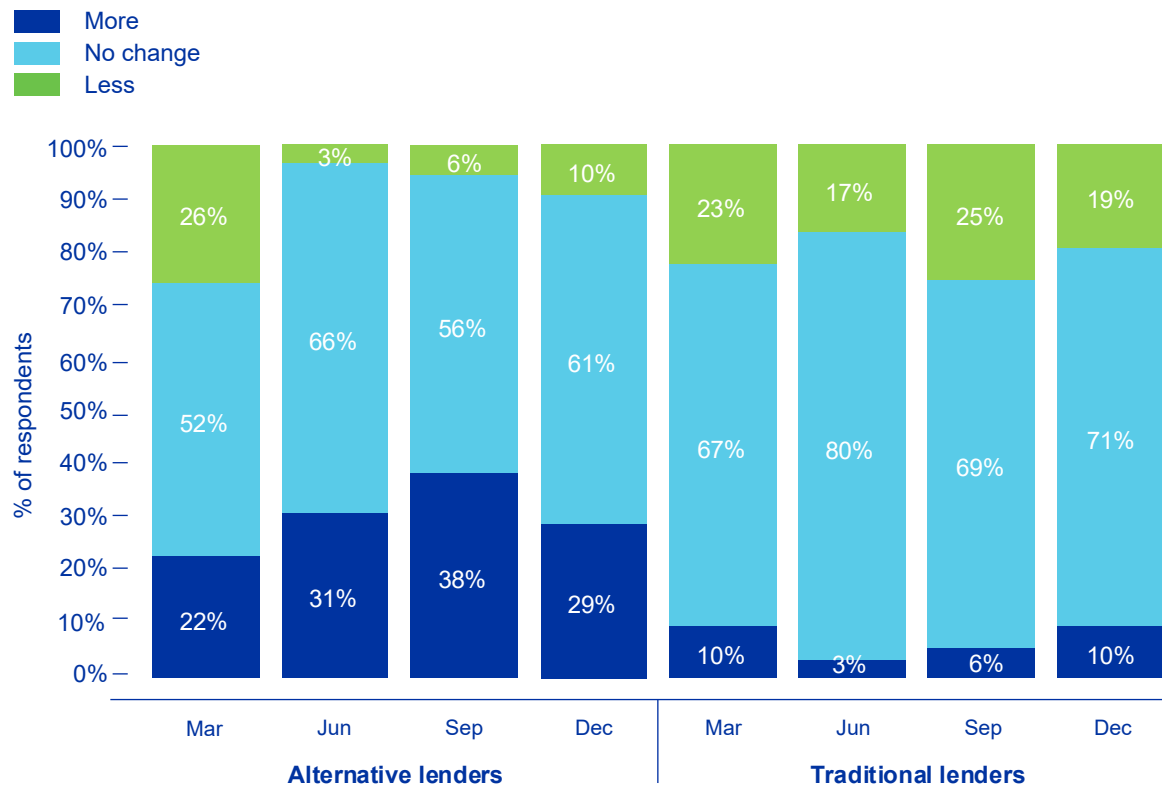
Figure 9: Change in net effective rent for new leases/lease renewals



The ‘higher for longer’ interest rate environment is bringing additional challenges for investors and managers of European real estate. Access and cost of financing is a growing concern, but it looks like non-listed real estate debt funds are proactively accessing this timely opportunity to step up. As banks are hesitant to increase their allocations to real estate, the Consensus Indicator Survey highlights that a growing share of respondents look to alternative lenders for their financing needs (see Figure 10).

‘Navigating the changing landscape of European real estate debt’ paper highlights a notable deleverage since the global financial crisis and how the evident growth of non-listed real estate debt funds not only increases diversity of lending sources and a healthy competition but should also bring more stability to the European real estate lending market.

Figure 10: Change in source of financing



Germany continues to be out favour, while the UK maintains most favourable sentiment

The UK remains the top investment destination, maintaining a net positive sentiment for the fifth consecutive quarter. On a net basis, the share of surveyed participants expressing their intention to increase weighting in the UK jumped to 25%. This is an improvement on the September's equivalent of 11% and back to the March's and June's results of 21% and 26%, respectively.

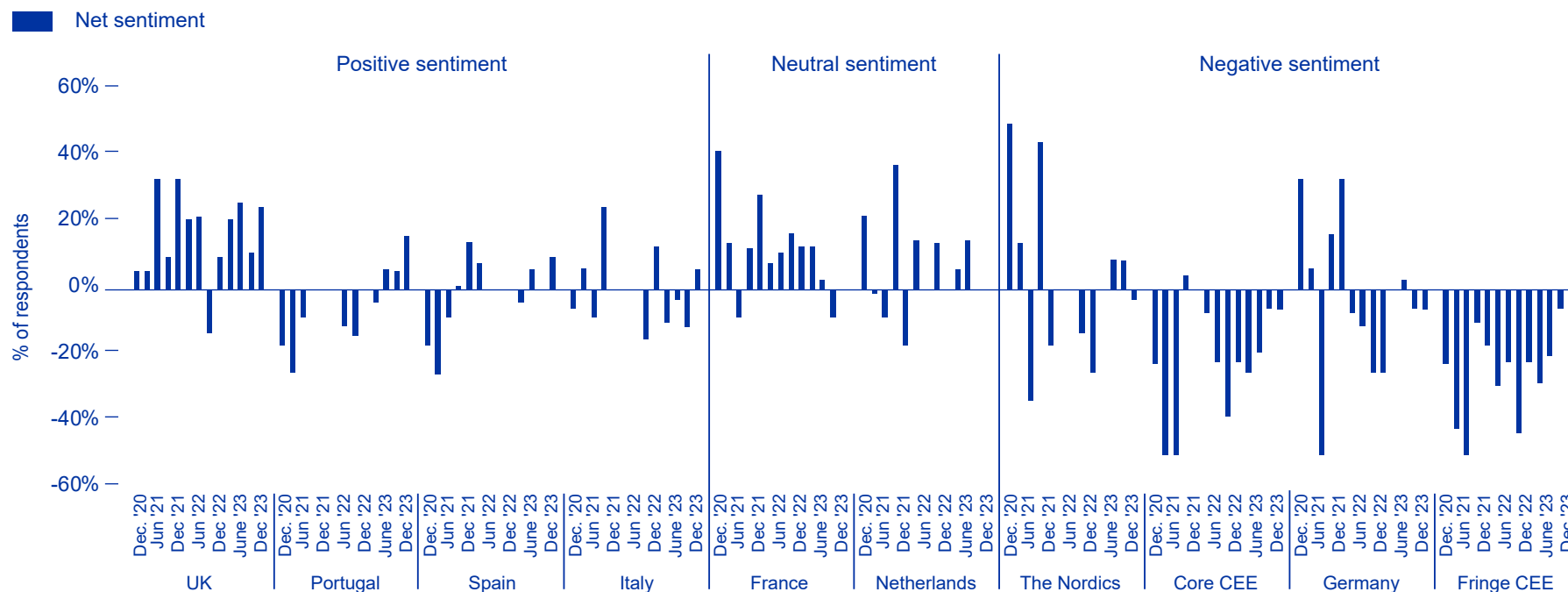
Conversely, Germany, one of Europe's largest real estate markets, continues to struggle with strong negative sentiment. Weak economic outlook and persistent valuation lags, particularly in comparison to the UK, likely account for this trend.

In noteworthy shifts, Italy and Spain transitioned into positive sentiment this December. This reflects selective interest towards certain sectors and assets, especially industrial/logistics, and is fitting with the structural shifts that larger western European markets have undergone over the last five to ten years.

Meanwhile, the Netherlands maintains its neutral standing for the second consecutive quarter. France, on the other hand, emerges back into a neutral position after a temporary negative sentiment in September.

The sustained sentiment towards the UK, the positive shifts for Italy and Spain, and the cautious approach towards Germany and France collectively reflect a nuanced landscape, influenced by valuation considerations, bottom up asset selection and a strategic reevaluation of investment preferences with yield premiums in mind.

Figure 11: Net sentiment towards European real estate by geography



Poor performance of the office sector leaves this segment with a clear negative sentiment, unchanged since June 2022. As mentioned earlier in the publication, the fundamentals for offices keep being challenged by the prevailing remote work dynamics, connectivity and demanding tenant requirements in terms of space configuration, flexibility and employee wellbeing. A lot of questions remain on the table regarding the ESG requirements and specifications.

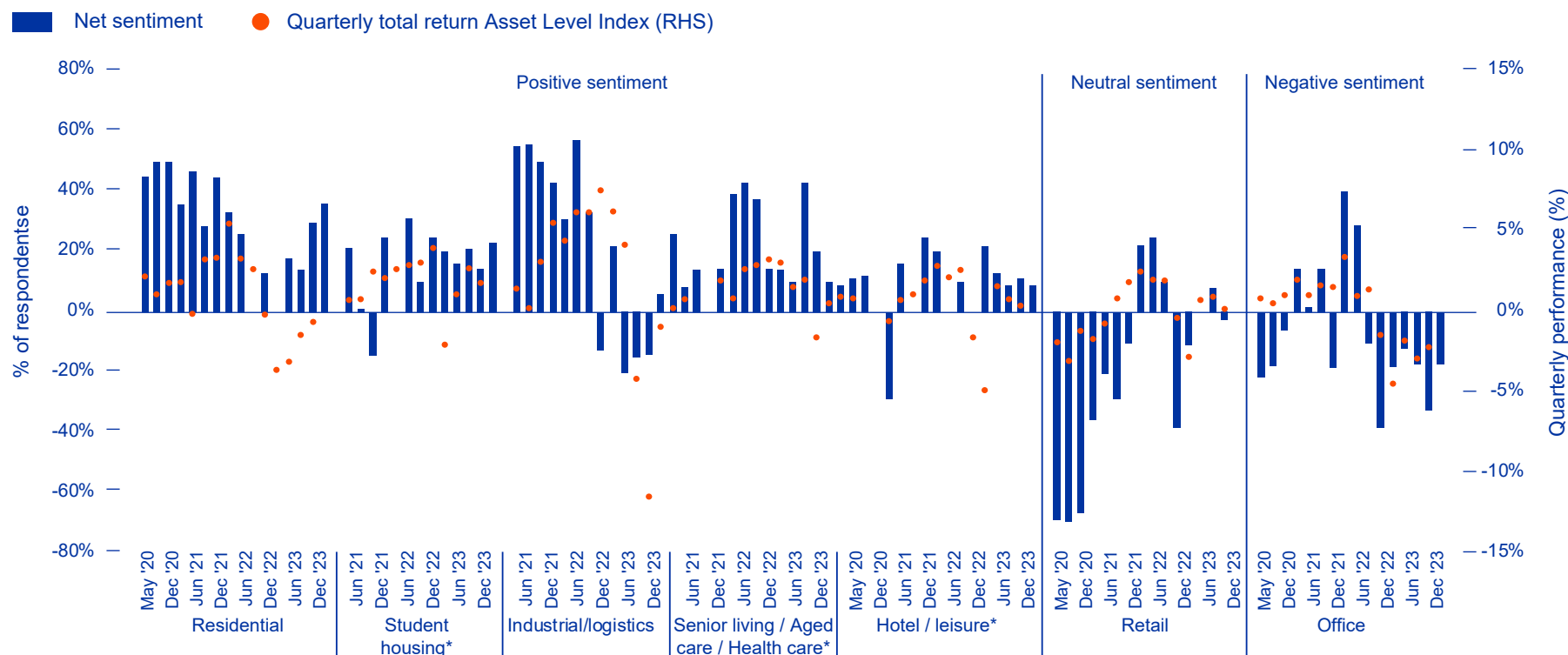
That said, while the net sentiment is negative, with 31% of surveyed participants looking to reduce office allocations, 14% are keen to increase them, reflective of the mix-bag outlook for the sector and the growing bifurcation between the best in class office space and the rest.

On the positive side, the living sectors are still the most preferred. The residential sector remains in first position, followed by student

housing, senior living and hotel/leisure. Meanwhile, industrial/logistics firmly maintains its positive sentiment, marking the fourth consecutive quarter in net favourable territory.

On the retail front, the picture is more complex. The sentiment is neutral this time around, coming back from September's negative result. The multitude of subsectors within this segment makes it harder to have a clear, high-level picture for European retail assets, even though its overall performance continues to be in positive territory.

Figure 12: Sentiment and performance by sector



Heightened risk, while views on performance deteriorate further

Risk and return expectations for European real estate deteriorated notably at the end of

2023. On a net basis, 28% of respondents surveyed indicated a more negative view on performance and 25% reported an increase in their assessment of investment risk. This reflects difficult market conditions for both investors and managers.

December INREV Consensus Indicator of 40.8 does not provide much hope for a sudden change and it may not be until much later in 2024 or even 2025 that the European non-listed real estate market will be on a fully fledged rebound.

Figure 13: View on European real estate performance

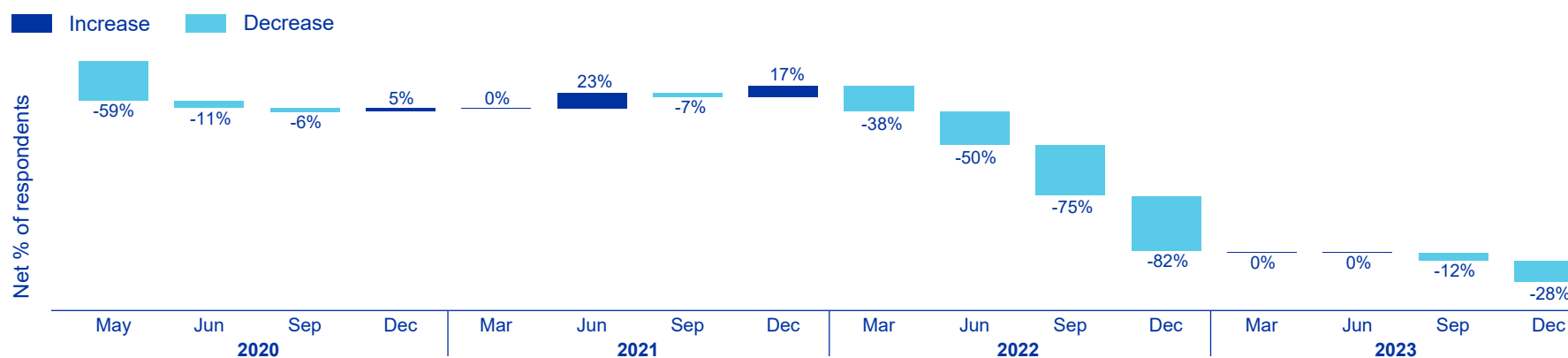
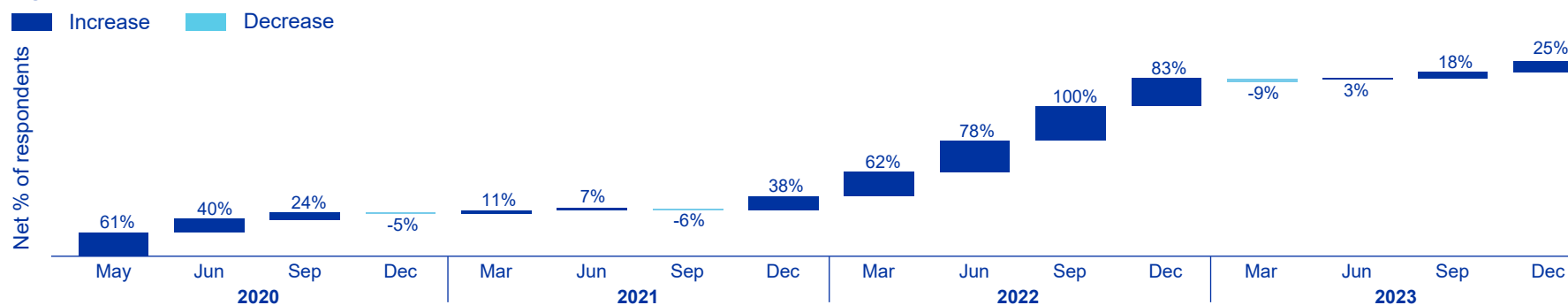


Figure 14: Assessment of investment risk for European real estate



Source: INREV Consensus Indicator Survey, 2023

This update highlights the latest results from the [INREV Pan-European Quarterly Asset Level Index Q3 2023](#), [INREV Quarterly Fund Index Q3 2023](#), [European ODCE Index Q3 2023](#), INREV Valuations Survey Q2 2023 and [INREV Consensus Indicator December 2023](#) to illustrate the impact on market performance, investments plans and operations.