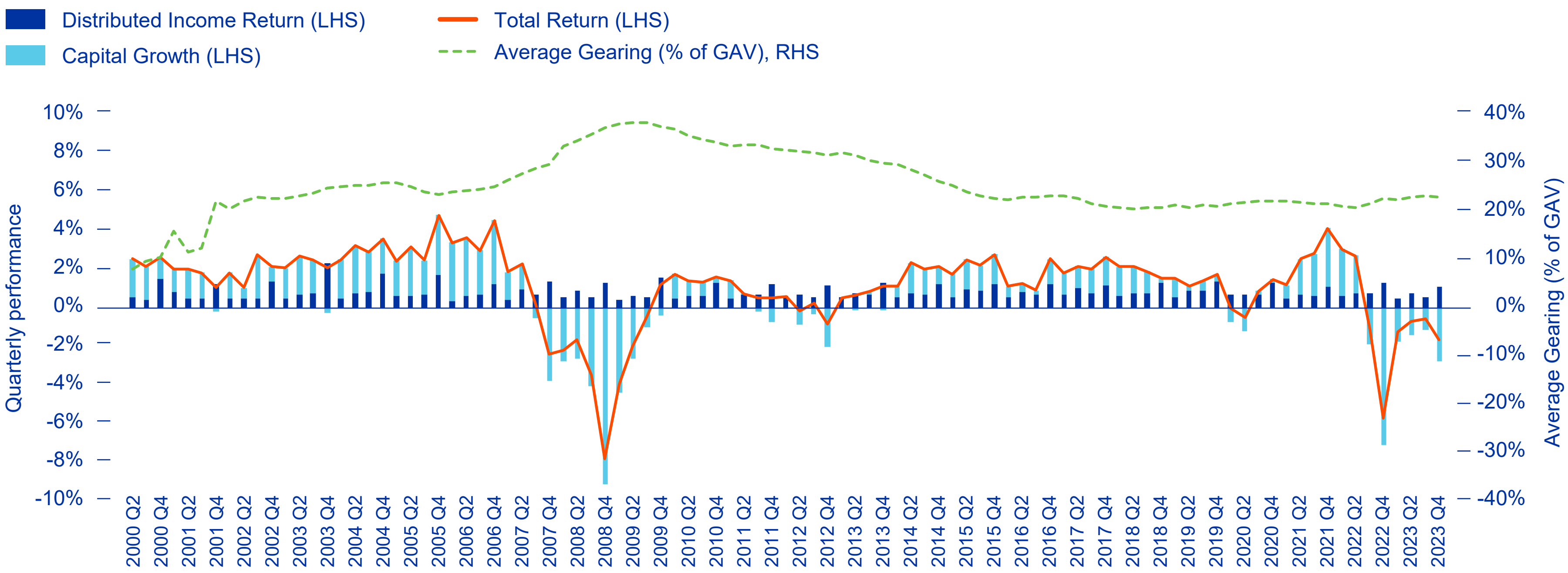
Market Insights on European non-listed real estate in March 2024

The latest edition of the INREV Market Insights reveals that the correction in European real estate is still ongoing. The Q4 2023 INREV Fund Index delivered a total return of -1.70%, a sharp decline from -0.56% reported in Q3 2023.

Capital growth remained the primary driver of negative performance, at -2.83%. This 165 bps quarter-on-quarter(q-on-q) decline marks a sixth consecutive quarter of falling values, bringing the total correction to -15.50%. As anticipated at year-end, a significant rise in income distribution by funds led to a higher distributed income return of 1.13%, a 52 bps increase from the previous quarter.

The latest March [INREV Consensus Indicator](), designed to capture market sentiment and turning points, reveals a more positive outlook with a headline reading of 50.2[1]. It is a notable increase from the 41.8 equivalent in December, as sentiment moves above 50 for the first time since we started to track the market consensus in March 2023 (see p.9 for more details).

Figure 1: European non-listed real estate performance



Source: INREV Quarterly Fund Index, Q4 2023

[1] A Consensus Indicator of above 50 represents growth, while a reading of 50 represents no change. A reading of under 50 indicates contraction. The further away from the 50 mark the results, the greater the level of change.

Germany and France see Q4 2023 returns slide close to Q4 2022 levels

The Q4 2023 INREV European Asset Level Index reports further correction, with a total return of -1.58%. The latest performance reflects a q-on-q decline of 119 basis points. Dispersion in performance across European markets remains high.

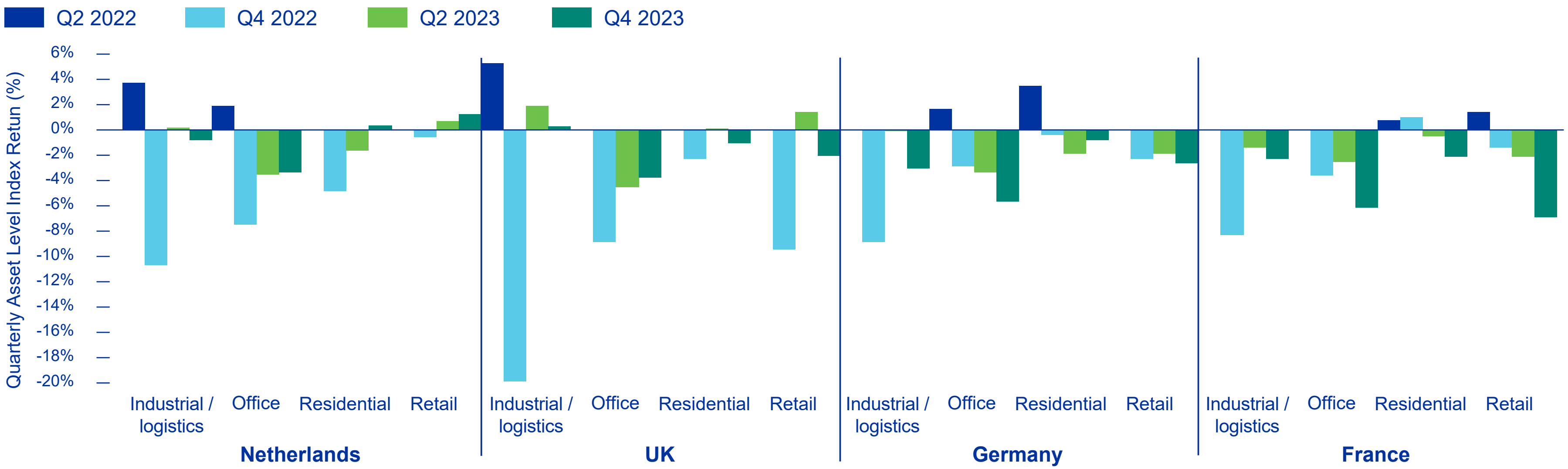
All main geographies within the index reported negative total returns. Dutch assets featured as the best-performing geography out of the main four, delivering a -0.10% total return. This Q4 result was notably helped by positive performance of retail (1.20%) and residential (0.30%) sectors.

The UK followed second (-1.05%), boosted by a slightly positive industrial/logistics asset performance of 0.23%. Germany and France witnessed a severe downturn in Q4, with a significant decline in performance across all main sectors. This is largely attributable to the frequency of valuations – in France, most valuations are carried out biannually while in Germany Q4 appraisals are the norm[2]. This is clearly reflected in the latest results, with German and French total returns sliding by 277 bps and 257 bps to -3.63% and -4.15%, respectively. These are not far off their weakest in the current downturn Q4 2022 returns of -4.07% and -4.19%, respectively.

Despite the differences in performance across major European markets, the sharp correction for office assets is strikingly uniform. At -4.53%, pan-European office assets reported their weakest quarter since the Index's inception in Q1 2014. This represents a significant underperformance compared to other sectors and a 242 bps q-on-q decline. The French and German office assets were the worst performing, with the respective -6.11% and -5.62% Q4 results (see Figure 2).

On a brighter note, residential assets emerged as the strongest performer among the four main sectors, with an improved Q4 return of -0.29%. Industrial/logistics assets followed, with -0.92%. Retail showed a more varied portrait, with positive returns in the Netherlands (1.20%) contrasting with the negative results for the UK (-2.04%), Germany (-2.59%) and France (-6.79%).

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



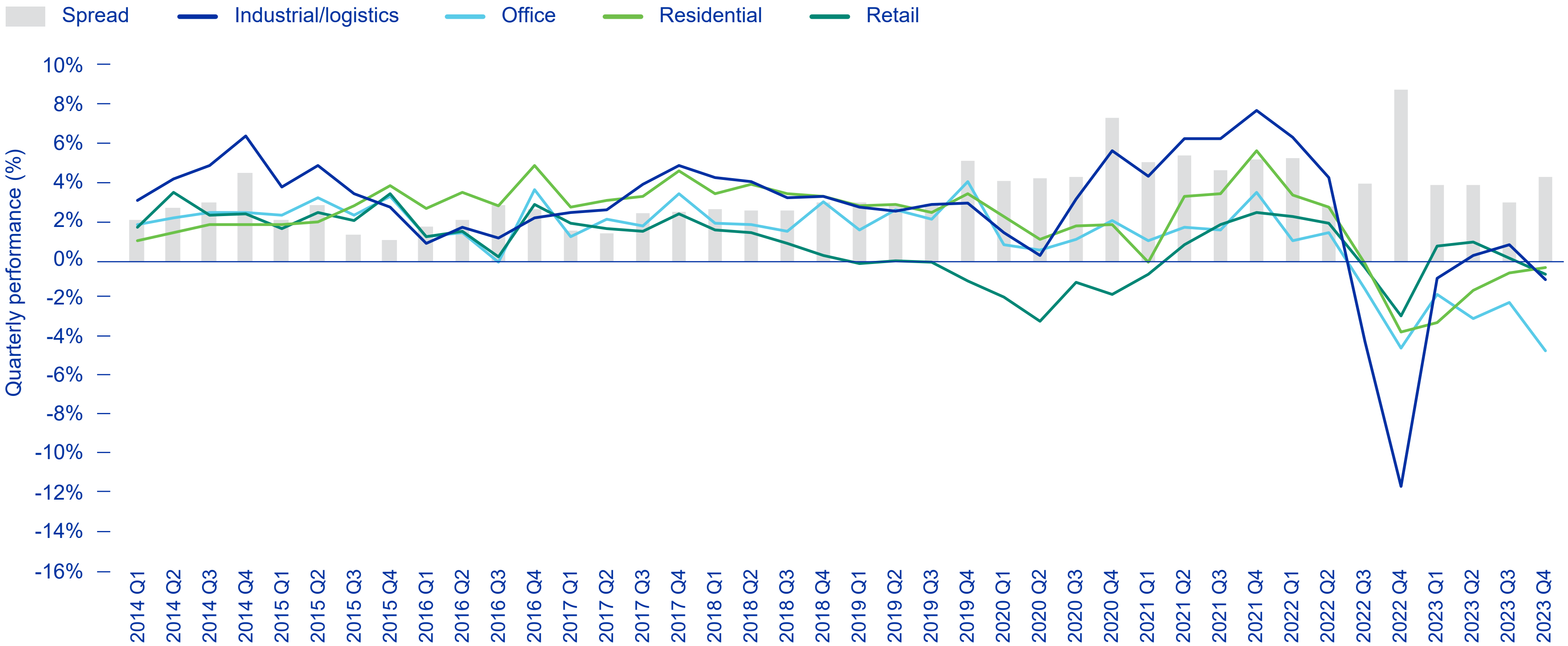
Source: INREV Quarterly Asset Level Index, Q4 2023

[2] INREV's European real estate valuations: understanding and interpreting results, October 2023

Stark underperformance of office assets widens sector performance gap

The latest results reveal a widening performance gap between the best and the worst performing sectors. It stood at 424 bps in Q4 2023, marking a 128 bps increase compared to Q3 2023. While this is higher than the ranges observed throughout 2023, it remains below the 864 bps peak recorded in Q4 2022, driven by the significant difference in returns off the back of a sharp industrial/logistics correction. Stark underperformance of office assets is driving the current gap, with the remaining main sectors (residential, retail and industrial/logistics) reporting relatively similar, albeit also negative, returns.

Figure 3: Performance of European real estate assets by sector



Source: INREV Quarterly Asset Level Index, Q4 2023

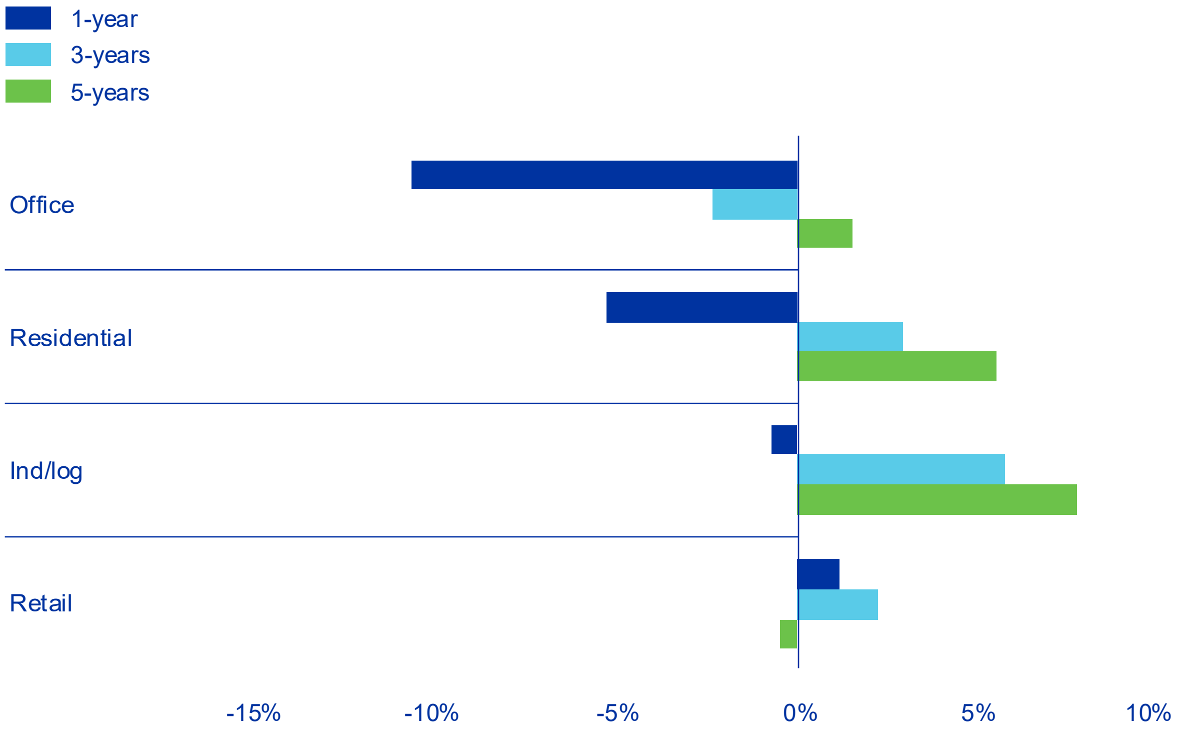
Uniform strong office correction, with industrial/logistics on the mend

At -10.79%, the uniformity of the strong correction of pan-European office assets is clearly evident in their annualised returns for the year. They are notably lower than their 3- and 5-year annualised results of -2.37% and 1.51%, respectively, underscoring a turbulent period for the sector (see Figure 4).

Industrial/logistics assets, on the other hand, have shown resilience, recovering from their lowest returns in Q4 2022. By the end of H1 2023, the sector achieved a near-neutral one-year annualised return of -0.71%, which is impressive given the Q4 2022 performance of -11.42%. The sector also displays the highest 3- and 5-year annualised returns, of 5.76% and 7.87%, respectively, given the tailwind demand pre- and during the Covid-19 pandemic.

Despite being the best-performing sector in Q4 2023, residential assets also recorded a strong negative one-year annualised return (-5.32%), much weaker than their 3-year (2.94%) and 5-year (5.55%) annualised returns. At 1.16%, the retail sector emerges as the only sector showing a positive one-year return. This marks an improvement from its 5-year performance (-0.47%), albeit falling short of its 3-year mark, indicating a nuanced geographical and subsector recovery.

Figure 4: Annualised performance of European assets by sector



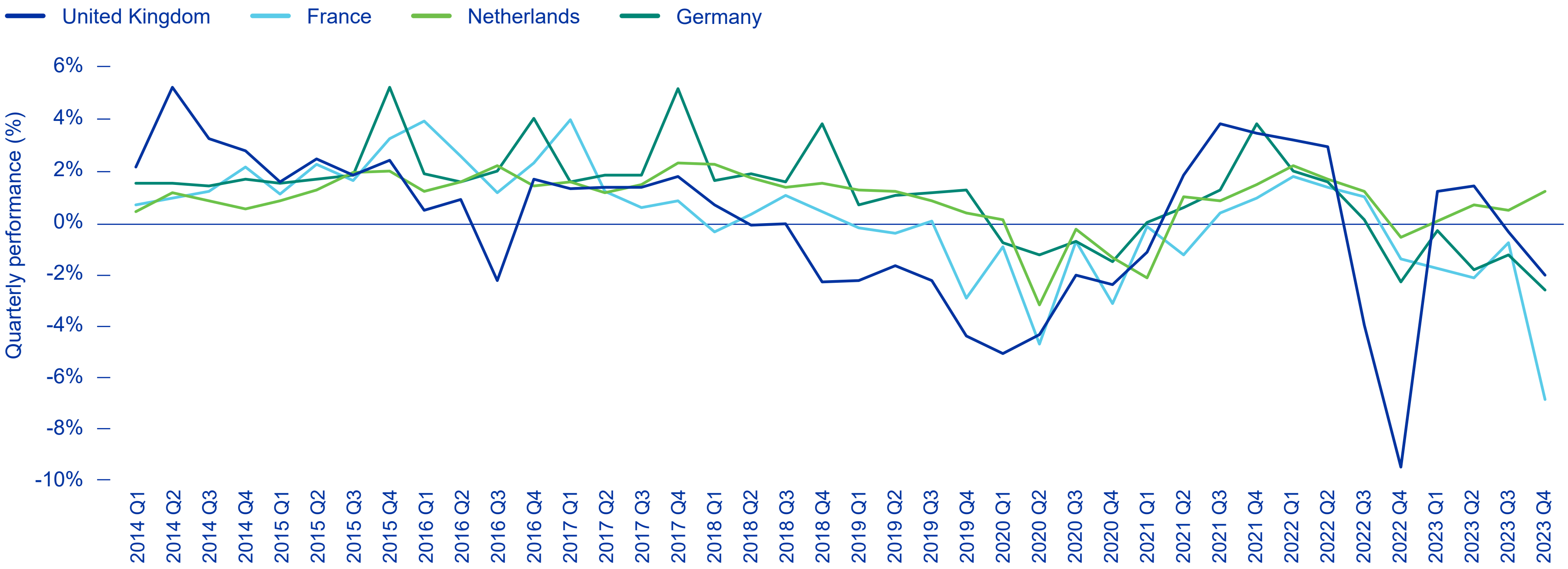
Source: INREV Quarterly Asset Level Index, Q4 2023

Nuances of retail performance

The Q4 2023 performance of the retail sector differs a lot across geographies, influenced by several factors, notably location, retail subtype and inevitably, the overall supply of the assets and e-commerce penetration.

On the one hand, the Dutch retail assets have exhibited a modest but steady recovery, with four consecutive quarters in positive territory with negative capital growth, while the UK and German retail returns slid down by 130-170 bps to -2.04% and -2.59%, respectively. French retail witnessed an even sharper Q4 perfromance decline to -6.79%, driven by the poor performance of their high street shops and shopping centres.

Figure 5: Performance of European retail assets by geography



Source: INREV Quarterly Asset Level Index, Q4 2023

Occupancy rates for most retail susbsectors remained relatively high and stable throughout 2023. This is especially pronounced for supermarket/superstore properties, which maintained an exceptional occupancy rate of 99.9%, solidifying their consumer staple asset class position. Their essential service designation, high income return characteristics and typically high quality tenants serve as a buffer against economic fluctuations.

Retail warehouses experienced a positive uptick in occupancy rates compared to 2022. This growth aligns with the continued surge of e-commerce, which necessitates efficient fulfilment centres. Conversely, other retail subsectors saw a small year-on-year drop in occupancy rates. Shopping centres were affected the most, a -262 bps year-on-year decline, bringing their pan-European 2023 year-end occupancy rate to 93.5%. The subsector remains under significant pressure, challenged by high occupancy and maintenance costs and changes in consumer preferences towards on-line shopping.

Figure 6: Occupancy rate by retail sub sector

Source: INREV Quarterly Asset Level Index, Q4 2023

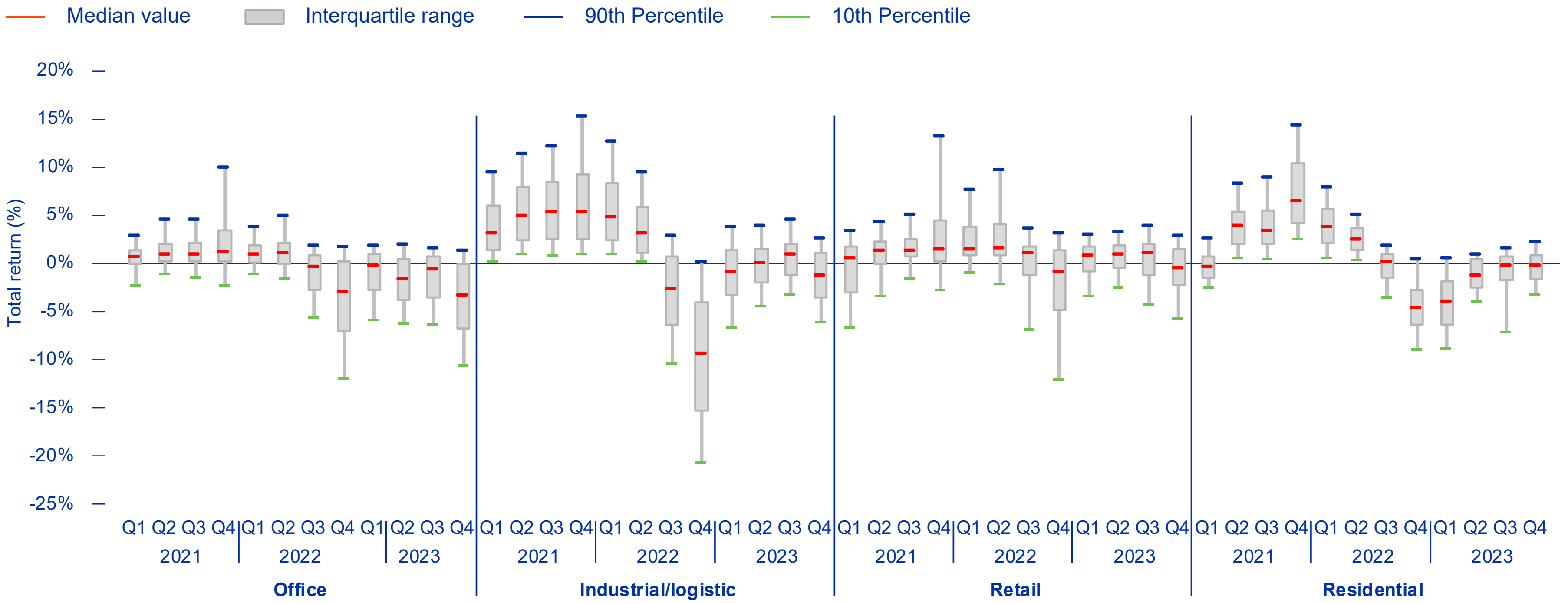
For the second quarter in a row, office assets displayed the highest performance range of 11.86%, measured as a difference between its 10th and 90th percentile. This highlights an ongoing bifurcation between prime and secondary offices, as documented in previous editions of INREV Market Insights.

The widening dispersion between its lower and upper quartile throughout 2023, currently at 6.62% and up from the 2021-H1 2022 quarterly average of 2.06%, highlights an increasing importance of asset quality selection.

Retail and industrial/logistics assets also displayed notable performance variations in Q4 2023. Their respective interquartile ranges are 4.67% and 3.71%, and the difference between the 10th and 90th percentile of around 8.60% for both. These indicate a substantial spread between top and bottom performers within each sector.

The Q4 2023 interquartile spread for residential assets is the lowest (2.55%) due to strong underlying sector fundamentals and high income return component. That said, the difference between the 10th and 90th percentile for the sector averaged at 7.35% over the 2021-2023 period, falling to 5.42% in Q4 2023.

Figure 7: Sector performance distributions



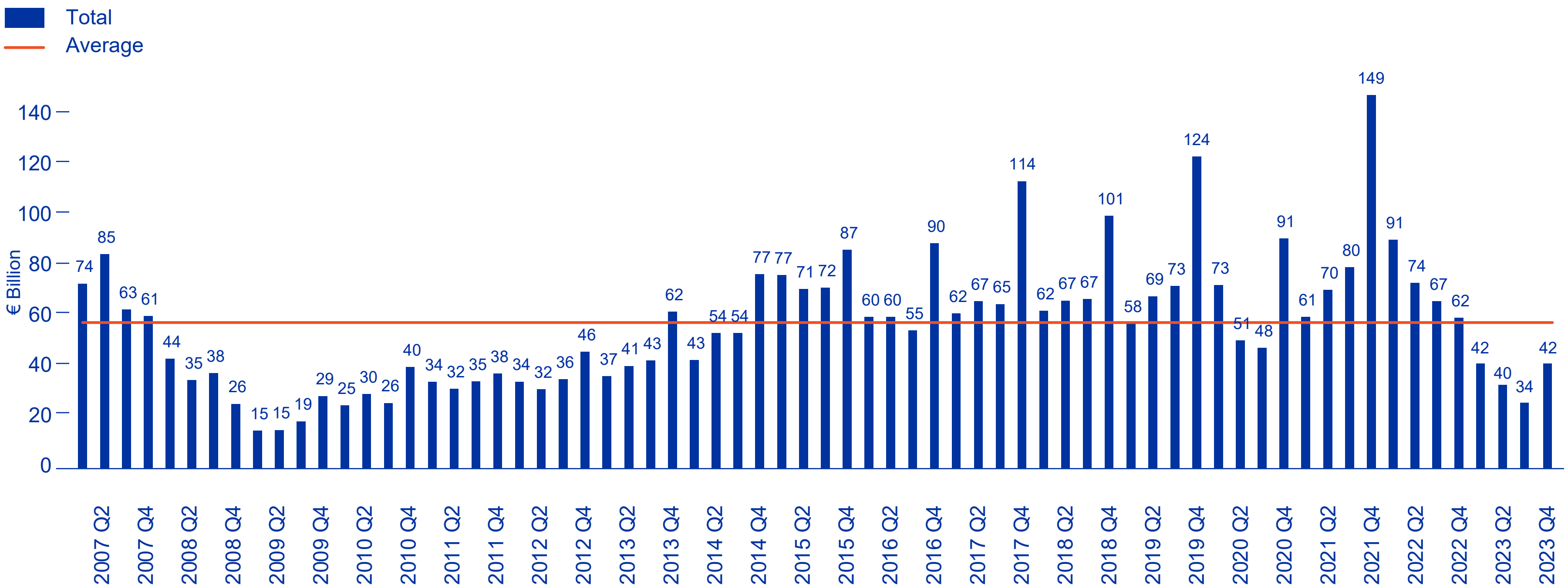
Source: INREV Quarterly Asset Level Index, Q4 2023

End of the longest time in history of European transaction volume declines

The European transaction volumes have increased to €42.1 billion in Q4 2023[3]. After seven consecutive quarters of declines, this marks the end of the longest time in history to see no rebound in investment activity. This is a welcome sign that the markets are starting to pick up but is still a long way away from the long-term quarterly average of €57.4 billion.

INREV Consensus Indicator confirms the uptick in sentiment, as the investment subindicator increased to 46.2, albeit it remains some way away from the above 50 mark that indicates growth. With six consecutive quarters of pricing corrections, there is an inclination that pan-European investment market liquidity will improve further as we move through the year.

Figure 8: Transaction volumes for European real estate



Source: MSCI Real Assets, March 2024

[3] MSCI Real Assets, March 2024

March INREV Consensus Indicator improves

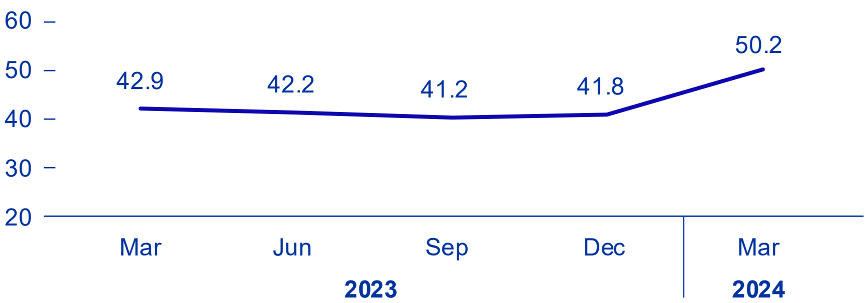
The INREV Consensus Indicator[4] reveals the first glimpse of improvement for the European non-listed real estate with the March headline reading of 50.2. It is a notable increase from the 41.8 equivalent in December, as sentiment moves above 50 for the first time since we started to track the market consensus in March 2023.

All five subindicators improved since December. Financing and investment liquidity subindicators increased the most, reaching 47.6 and 46.2, respectively. The new development subindicator is the weakest this March, at 44.8. Despite the positive trajectory, all three remain in the sub-50 territory, indicating on-going contraction / negative sentiment.

The economic subindicator looks more promising. Off the back of an improved economic outlook and more contained inflation levels it increased to 55.1 this March. It is a marked improvement from 46.2 in December and 53.4 reported a year earlier.

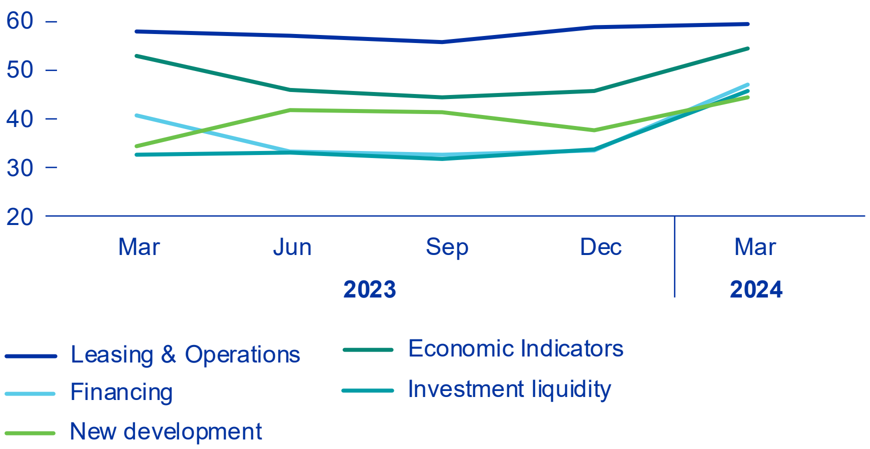
Leasing and operations maintains the lead and is the only subindicator to reach the above 60 mark. The improved economic outlook supports the ongoing net effective rental growth of participating organisations. Net rent improvements are reported across all sectors but offices (see Figure 11).

Figure 9: INREV Consensus Indicator



Source: INREV Concensus Indicator, 2024

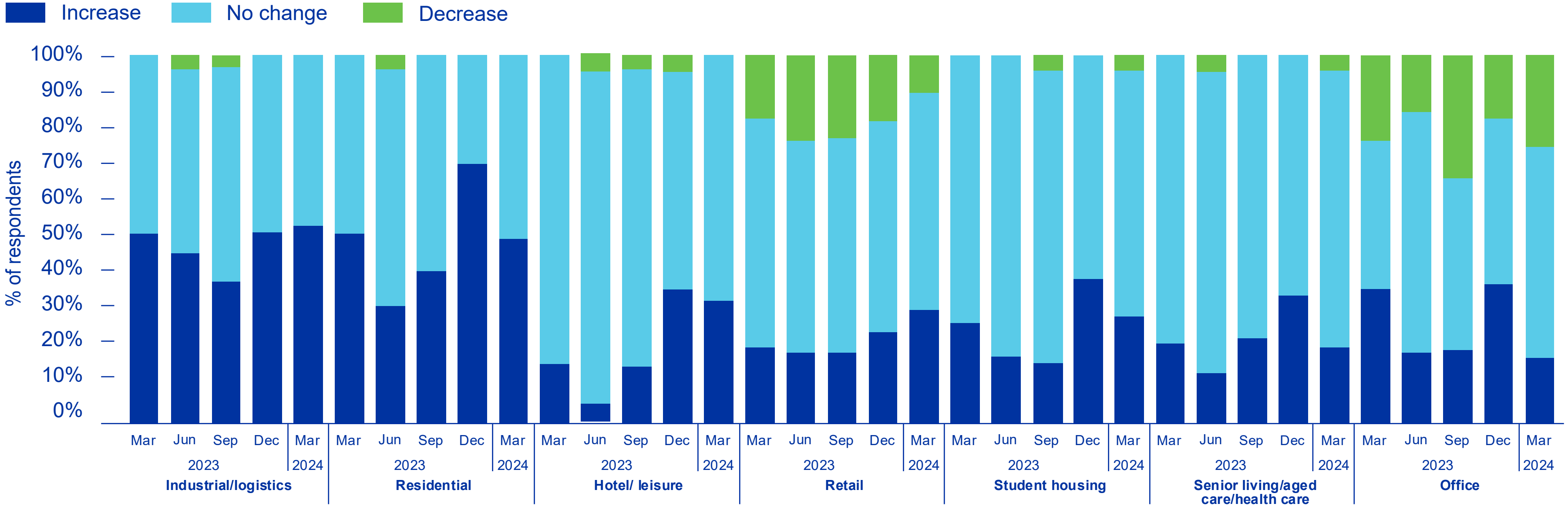
Figure 10: INREV Consensus subindicators



Source: INREV Concensus Indicator, 2024

[4] 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.

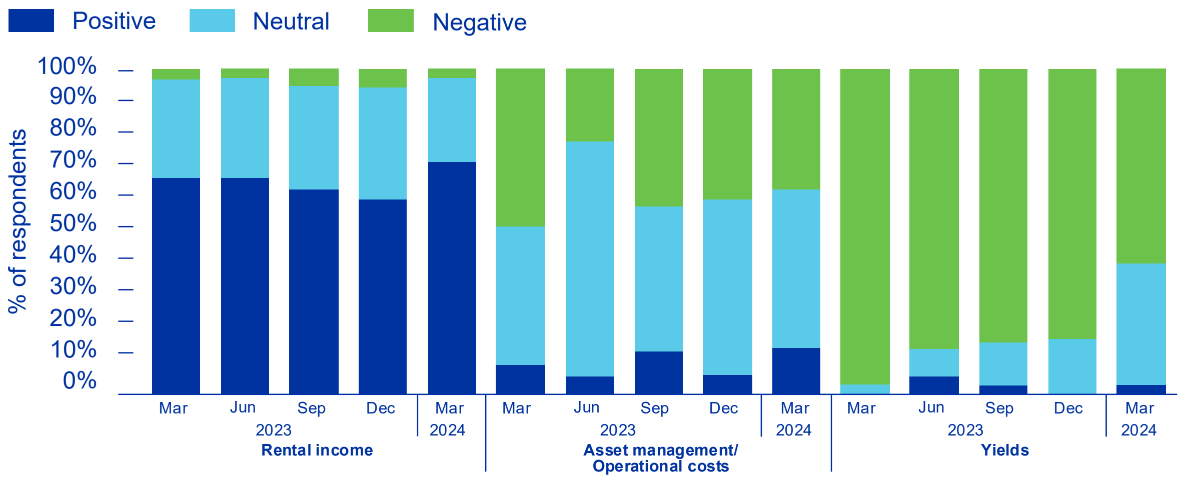
Figure 11: Change in net effective rent for new leases/lease renewals



The bottom line is that over 71% of participants expect Q2 2024 performance to be rental growth driven, while 60% expect further expansion of yields. On a net basis, these results are equally strong, with 69% expecting rental growth to have a positive impact and 57% expecting a negative impact from yield movements in Q2 2024.

It is worth noting that on a net basis, almost 23% of participants expect active asset management/ operational costs to have a negative impact on Q2 2024 performance, albeit, at 14.3%, the share of those who anticipate it to be a positive delta is at the highest since the monitoring began in March 2023.

Figure 12: Drivers impact on next quarter's performance



Source: INREV Consensus Indicator Survey, March 2024

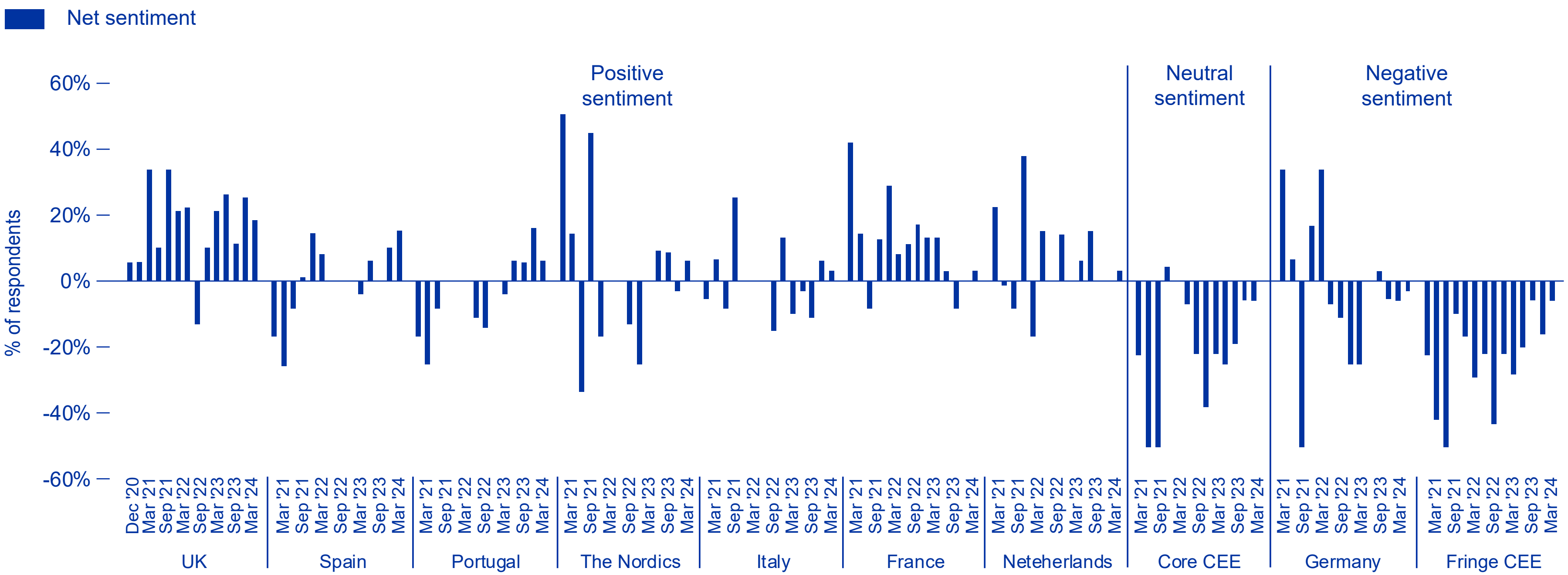
Positive shift in sentiment for most geographies, albeit remaining negative for some

The latest results reveal a positive shift in sentiment for most geographies. France and the Netherlands timidly transitioned into positive territory this March, both at 3% on a net basis of surveyed participants. With a strong negative performance of the French market in Q4 2023, an extent to which this positive sentiment will be maintained through the year it is yet to be seen.

For a sixth consecutive quarter, the UK remains the top investment destination. The net share of surveyed participants expressing their intention to increase their UK weighting diminished slightly to 18%, compared to 25% in December. This continues to surpass Spain, which climbed into a second spot with 15% on a net basis. In fact, the net positive sentiment for Southern European markets continues to improve. Portugal and Italy remain in the net positive territory, although the net share of participants seeking to increase their weightings moderated slightly to 6% and 3%, respectively.

Germany remains firmly in the net negative sentiment. This concurs with the latest weak performance results. Over the last quarter, its net sentiment climbed to -3% from -6% in December. It remains to be seen if the latest pricing corrections will trigger more interest. Core and Fringe CEE markets have also improved, albeit to respective net neutral and a -6% positions.

Figure 13: Net sentiment towards European real estate by geography



Source: INREV Consensus Indicator Survey, March 2024

Residential/livings sectors top demand

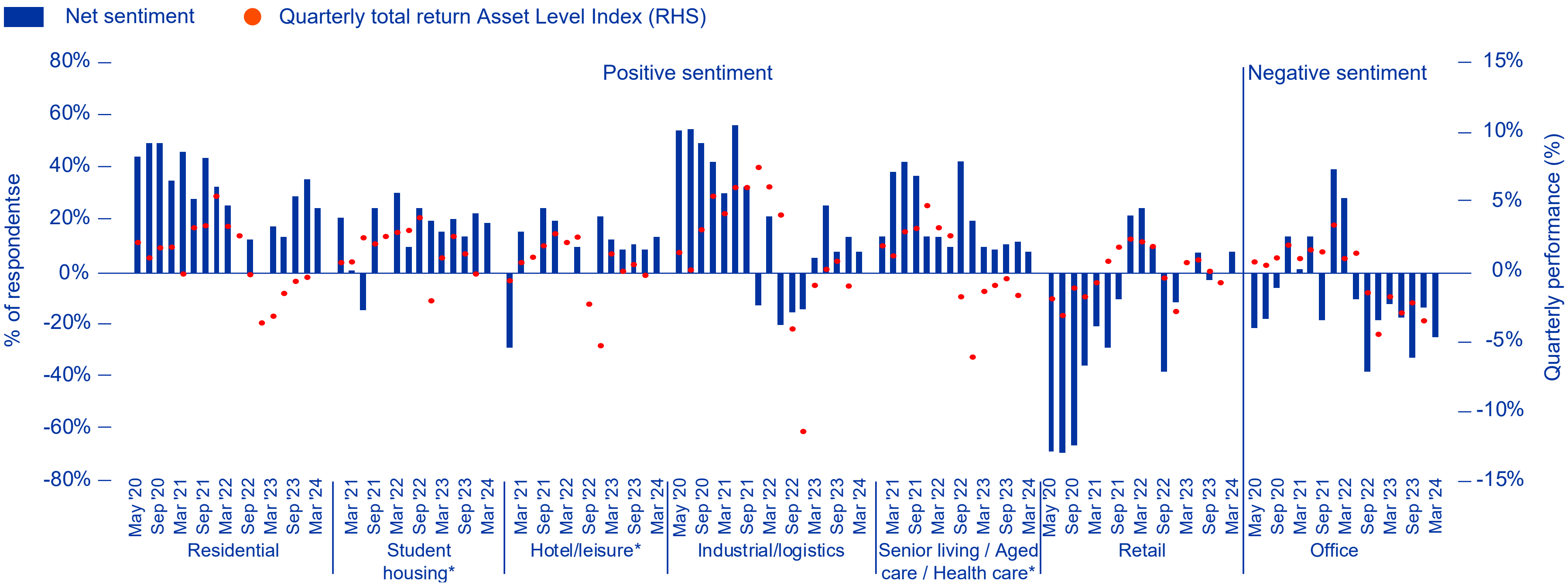
Unchanged for the past three editions of the publication, all residential/living sectors remain highly preferred amongst the surveyed participants. Residential and student housing stay in the top two net positive sentiment positions, with 25% and 19% of surveyed participants looking to increase respective allocations.

This aligns with the latest results of the [INREV Investment Intentions Survey 2024](), where residential ranked first in investors' sector preferences. The performance of the sector has been improving throughout 2023, finishing on a high note as the best-performing European sector in Q4 (see Page 2).

The hotel/leisure sector also exhibited a positive shift, climbing to the third-preferred sector position, with 14% net positive sentiment, and surpassing industrial/logistics (8%). Conversely, office assets continue to face significant headwinds. Reflective of these concerns and the record-low Q4 2023 performance, the net share of participants intending to decrease their office exposure remains high, at 25%. This is a deterioration from a December equivalent of 17%.

Industrial/logistics remains in the net favourable territory (8%), while retail (8%) emerged from a net negative and a net neutral sentiment in September and December, respectively. It is crucial to acknowledge the need for market- and sector-specific analysis as performance trajectory varies significantly across retail segments (see pp. 5-6).

Figure 14: Sentiment and performance by sector



Source: INREV Consensus Indicator Survey, March 2024
INREV Quarterly Asset Level Index, Q4 2023

Assessment of investment risks diminishes as view on performance improves

March 2024 results revealed the first net positive view on performance since December 2022. A net positive performance sentiment of 8% amongst respondents surveyed stands in a sharp contrast to the December 2023 results, where net 28% of respondents indicated a more negative view on performance. The change is also reflected in views on the investment risk. On a net basis, 23% of respondents reported a decrease in their assessment of investment risk relative to the previous quarter.

At 50.2, the latest March INREV Consensus Indicator reflects a clear shift towards a more positive sentiment, but it is premature to declare this as a turning point in the cycle.

Figure 15: View on European real estate performance

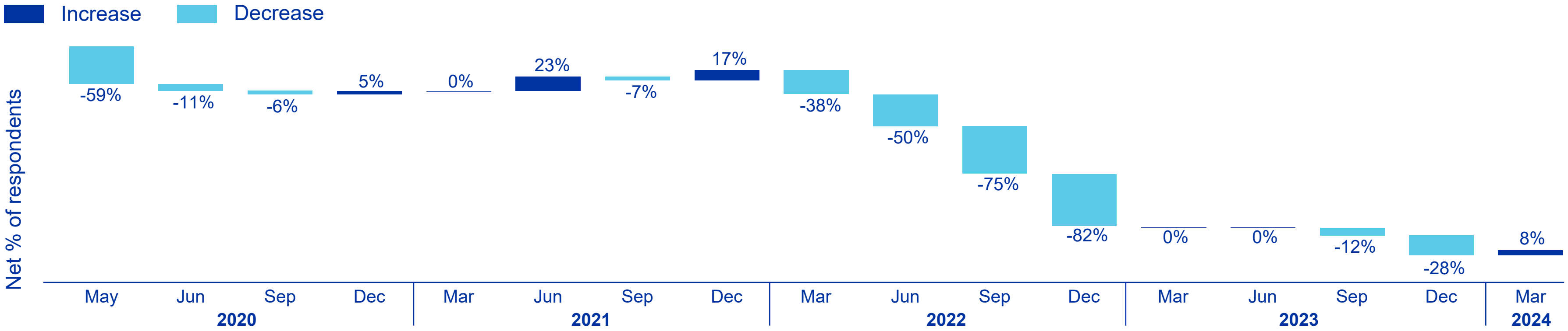
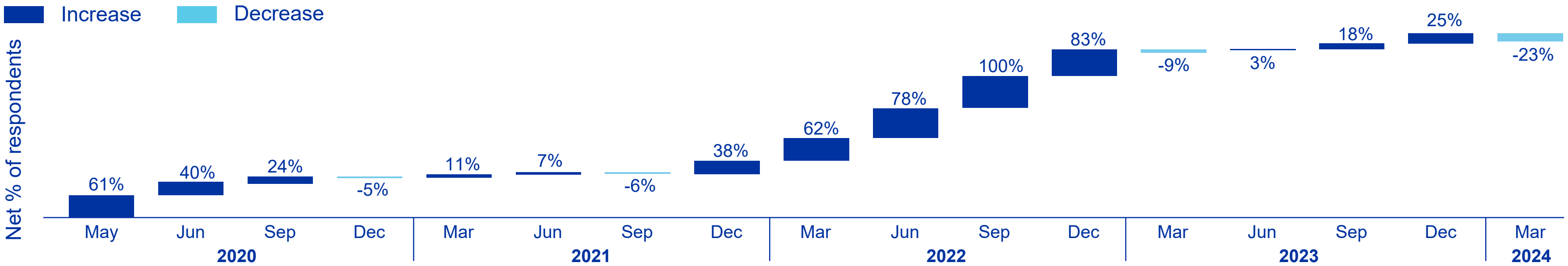


Figure 16: Assessment of investment risk for European real estate



Source: INREV Consensus Indicator Survey, 2024

This update highlights the latest results from the INREV European Quarterly Asset Level Index Q4 2023, INREV Quarterly Fund Index Q4 2023, INREV Valuations Survey Q4 2023 and INREV Consensus Indicator March 2024 to illustrate the impact on market performance, investments plans and operations.