Intelligent Investment

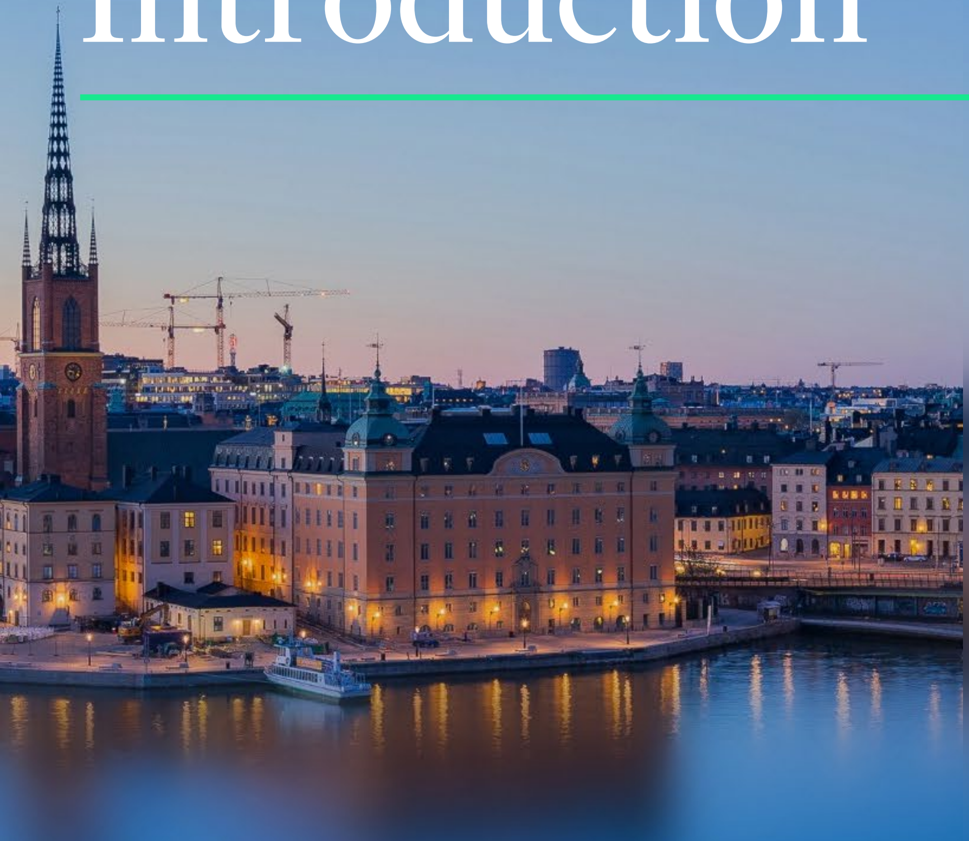
Market Outlook 2024

REPORT

EUROPE
REAL ESTATE

CBRE RESEARCH

Introduction



2023 was a year of weak economic growth across most of Europe, with households and businesses burdened by the effects of elevated inflation and a sharp interest rate hiking cycle. Property investment activity slackened for some of the same reasons. But what can we expect from 2024?

It will be another year of weak growth, although somewhat stronger than the previous one. Risks are still skewed to the downside, and mainly centre around geopolitical tension and stubborn core inflation. Policy interest rates look as if they have peaked, and inflation will continue its downward path over the year. Long-term interest rates started to fall in October and further moderate declines are forecast for 2024.

Against this background, we see an improving landscape for property investment. Values look set to bottom out in 2024, and stabilising values will gradually bring some convergence in buyers' and sellers' price expectations. We expect investment volumes to rise by about 10% compared with 2023.

Occupier markets will present a mixed picture, with growing polarisation between the best assets and the rest. We expect office leasing to pick up, but it will be slow progress. Logistics take-up will continue to ease down from earlier record highs, while in retail, better consumer fundamentals should improve footfall and sales figures. The living sector will continue to face structural undersupply challenges and strong occupier demand. Similar demand-supply imbalances will be apparent in other sectors such as hotels and data centres.

Finally, sustainability will be a growing influence on real estate decisions across all sectors. Different players in the market will be looking harder for alignment in their ESG agendas, and the quest for better data on the costs and benefits of sustainability decisions will accelerate.

Contents

01 Macroeconomics

02 Capital Markets

03 Office

04 Logistics

05 Living

06 Retail

07 Hotel

08 Data Centres

09 Sustainability

01

Macroeconomics

Better, but still weak, economic growth is in prospect for 2024, as the delayed impact of higher interest rates feeds through. Geopolitics and stubborn core inflation are downside risks, but positive growth momentum should be evident by the second half of the year.

Key Takeaways

01

Weak economic growth is likely to make 2024 a challenging year for real estate markets, but falling interest rates will act as a counterbalance in boosting growth and contributing to a capital markets revival.

02

Although still well above the 2% target in most European markets, inflation is falling rapidly. By Q4 2024, we expect Euro Area and UK headline CPI inflation to be 1.8% and 2.6% respectively, with the UK reaching the 2% target early in 2025. Real wage growth on the back of falls in inflation is a potential upside.

03

The next policy interest rate moves are likely to be downward. The first cut by the ECB could be as early as Q1 2024 if the economy remains weak. Cuts by the Bank of England are not expected until H2. 10-year government bond yields have already peaked, and we expect them to decline gradually through 2024 and beyond, but to remain well above the ultra-low levels of 2015-2021.

Economic growth to remain weak, but with inflationary pressures easing

WEAK ECONOMIC GROWTH EXPECTED IN 2024

2023 had a promising start, but economic growth weakened over the course of the year. Another weak year is forecast for 2024, before a more convincing revival in 2025.

There are several key factors affecting growth. The delayed impact of higher interest rates could be negative for both consumer spending and investment. Banks are also lending more conservatively due to an increased risk of default.

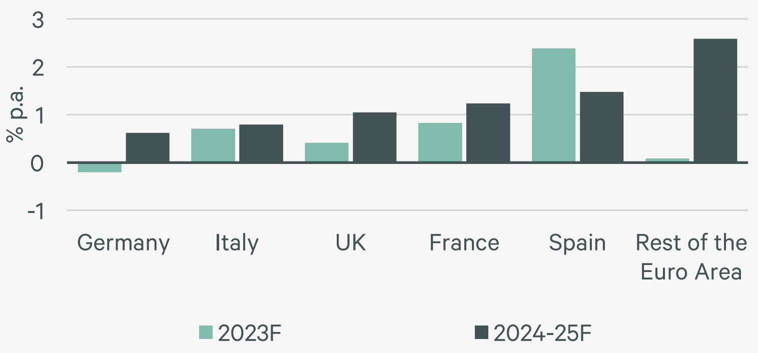
Households are rebuilding their savings after using them to meet higher energy and food bills in 2022 and 2023. Governments are under pressure to recover some of the previously subsidised energy costs and to deal with the higher debt servicing costs and elevated public debt. Finally, weak world trade volumes are affecting some economies, especially Germany and its main trading partners.

More positively, falling inflation means that real wages are starting to grow, and interest rates have stopped rising. These factors will help to drive a pick-up in growth, although it is likely to be H2 2024 before this trend gains clear momentum.

Figure 1: Real GDP Change, Western & Central Europe

Source: CBRE Research

Figure 2: Real GDP Change by Country



Source: CBRE Research

Weak economic growth will have a direct impact on the occupier side of the property market. Office-based employment is expected to grow more slowly in the major office markets (from 3.5% in 2023 to 0.7% in 2024), which, on its own, will temper demand for office space.

Slowly improving retail sales and consumer spending growth, meanwhile, will frame demand for retail, logistics and leisure-related property. Reduced spending power and the steep increase in rents in 2022-2023 could create affordability issues in multi-family housing.

MAIN RISKS TO THE OUTLOOK

There are two principal risks to the outlook. The first is geopolitical – an escalation of the crisis in the Near East or an exacerbation of geopolitical tension elsewhere could cloud business and consumer confidence and threaten higher commodity prices.

Secondly, sticky core inflation, or higher inflation caused by higher commodity prices, could defer the timing of interest rate cuts or even threaten further increases.

Inflation expected to fall, cuts to interest rates likely

FALLING INFLATION

A combination of factors, such as the post-pandemic supply-chain disruption and the war in Ukraine in particular, pushed inflation to very high levels in 2021 and 2022. Lower energy prices and stabilising food prices led to large falls in inflation in 2023. However, higher wage growth in response to earlier inflation rises has meant that “core” inflation has been quite sticky. This now appears to be coming under control and it is likely that many countries could see inflation close to, or even below, the 2% target by the end of 2024.

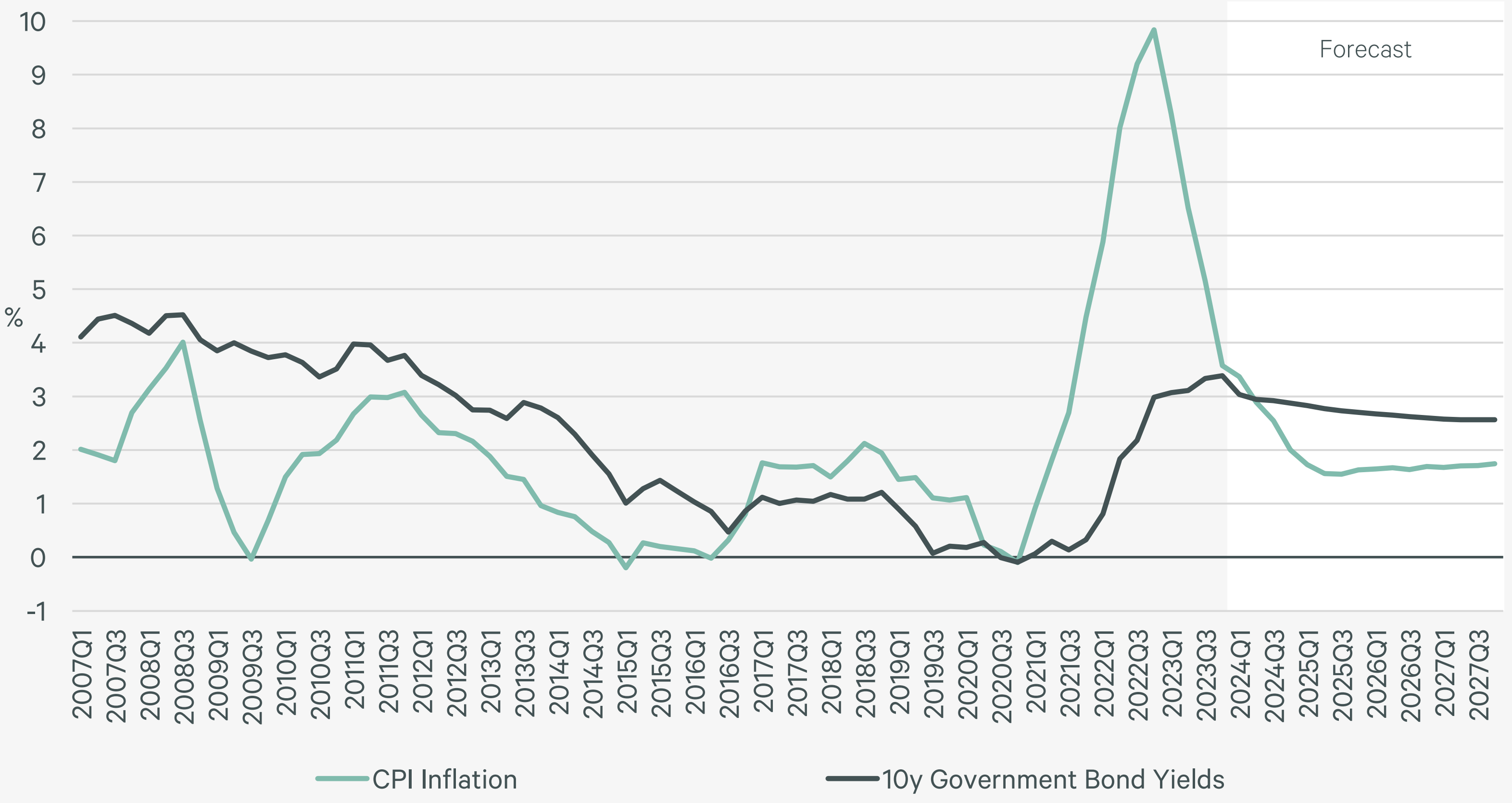
LOWER INTEREST RATES EXPECTED IN 2024

Lower inflation and a weak economic background has meant that most central banks, the ECB and Bank of England included, have paused interest rate increases sooner than expected. If inflation continues its downward path as we expect, rate cuts are likely in 2024, initially by the ECB in H1 followed by the Bank of England in H2.

GOVERNMENT BOND YIELDS LIKELY PAST THEIR PEAK

Despite policy rates levelling off, 10-year government bond yields and other long-term debt costs hit new post-GFC highs in the Autumn of 2023 but have been falling since late October. We think long rates have passed their peak and are unlikely to ever get back to the very low levels seen between 2015 and 2021. Together with lower inflation, this means that we can look forward to several years of gradual declines in long-term interest rates. This will eventually bring some much-needed relief to property investment markets and property values.

Figure 3: CPI Inflation and 10-year Government Bond Yields, Western Europe



Source: CBRE Research

02

Capital Markets

Investment activity is expected to pick up in the second half of 2024, as clarity on new price levels supports activity. Improved capital market conditions and loan maturities will create transaction opportunities. However, the upturn will be gradual as the financing environment is expected to remain tight.

Key Takeaways

01

The European real estate market is expected to see prime capital values bottom out in 2024. However, we do not expect a strong general rebound in values for as long as the cost of debt remains elevated, which is expected to be the case for most of 2024.

02

The dry powder available for investment in European real estate remains substantial. Most of this capital is destined for value-add and opportunistic strategies, underlining the challenge for the core segment of the market as investors remain on the sidelines in anticipation of potential tactical opportunities.

03

Deal activity is expected to pick up in 2024 as capital values solidify and capital markets conditions improve. Stabilising values will give buyers and sellers more comfort around new price levels. In addition, transaction opportunities may arise from loan maturities.

European prime capital values expected to bottom out in 2024

VALUES EXPECTED TO BOTTOM OUT IN 2024 AS LONG RATES PEAK

The European real estate market will likely see prime capital values bottom out in 2024 in most sectors as interest rates stabilise. While interest rates are considered to have peaked in late 2023, earlier rate rises will continue to affect property yields as markets adjust to higher rates. However, there is substantial variation between sectors and geographies when it comes to current and forecast capital value change (Figure 4).

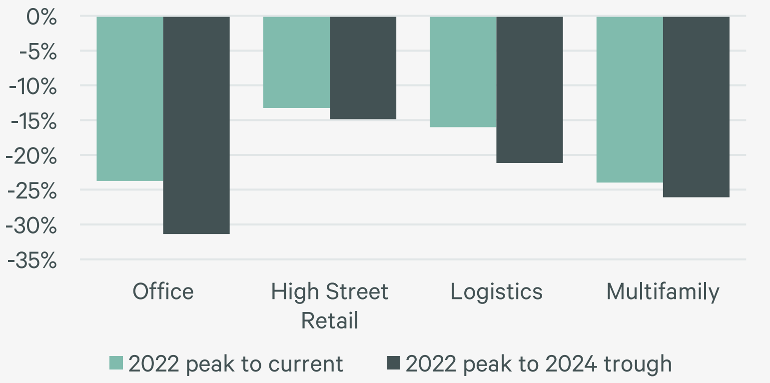
The extent of further repricing is likely to be less than has already taken place between H2 2022 and H2 2023. At current levels, the impact of a change in yields on values will be moderate. We do not expect a strong positive rebound in values to occur for as long as the cost of debt remains high, which is expected to be the case for most of 2024.

SECTOR OUTLOOK

Logistics has seen the quickest repricing but is now also the first sector to see values bottom out towards the end of 2023 and into 2024. Part of the repricing has been offset by strong rental growth.

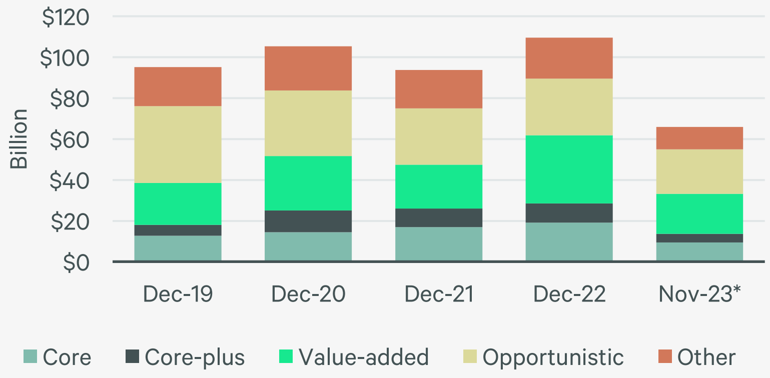
The office sector has seen substantial yield shifts, as higher interest rates have softened pricing. The sector is also facing uncertainty arising from changes in occupiers' workplace strategies, and this combination is causing yields to soften further as investors reassess income growth prospects. We expect office yields to reach a peak in 2024.

Figure 4: Current and Forecast Change In Prime Capital Value



Source: CBRE Global Forecasting & Analytics, Q4 2023

Figure 5: Unallocated Capital Targeting European CRE



Source: Preqin *Estimate

Multifamily yield shift has been lagging behind the aforementioned sectors. Despite robust investor interest, some further yield expansion will be required in 2024 before the respective price positions of buyers and sellers can realign.

Repricing in high street retail started well before the 2022 market correction but has since advanced at a slower pace than the other sectors. We expect that the sector will continue to see some upward pressure on yields before peaking in 2024 or 2025, depending on the market.

Hotel owners will continue to be buoyed by favourable operating fundamentals, and are reluctant to lower asking prices, so any increase in yields is likely to be modest. Buyers on the other hand remain patient, hoping that falling inflation will lead to lower borrowing costs ahead.

MOST AVAILABLE CAPITAL TARGETING VALUE-ADD AND OPPORTUNISTIC STRATEGIES

Dry powder available for European real estate declined in 2023 when compared with the previous year, the result of both capital outflows and a decline in fundraising. However, there is still $66bn of capital on the sidelines waiting to be deployed in European real estate (Figure 5). Out of which, almost 63% is targeted towards value-add and opportunistic strategies.

The amount of capital available for core and core-plus makes up 21% of total dry powder. This illustrates the challenge of the current market environment – limited capital targeting core product, but plenty waiting on the sidelines for tactical opportunities arising from a potential market dislocation.

Deal activity expected to pick up in the second half of 2024

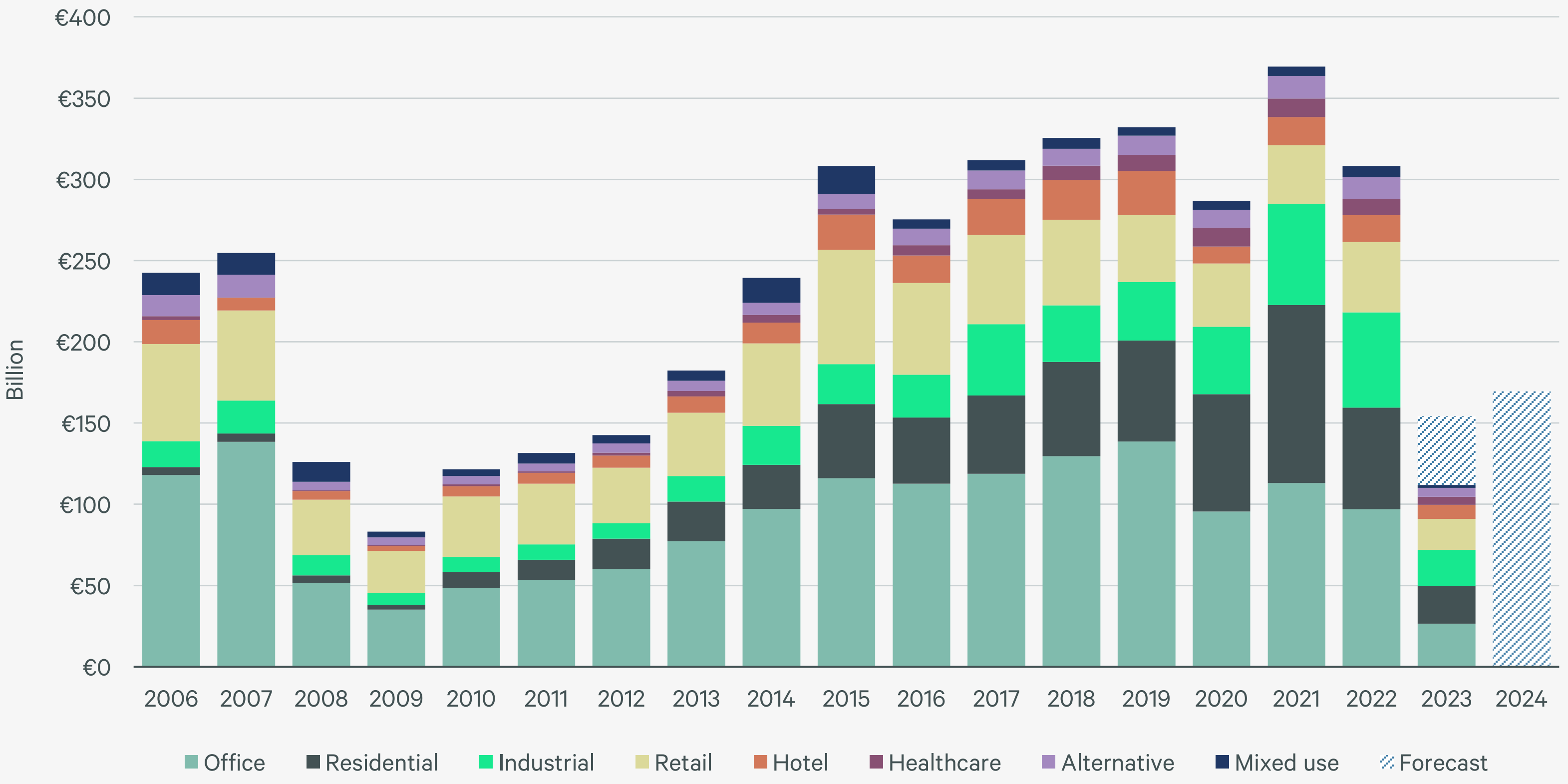
CLARITY ON NEW PRICE LEVELS TO SUPPORT DEAL ACTIVITY

Stabilising values will give buyers and sellers more comfort around new price levels. That said, growth in deal activity will be gradual as price discovery continues. Meanwhile valuations will catch up with the rapid change in market pricing which will further reduce the bid-ask spread.

We expect to see an increase in investment volume of around 10% in 2024 compared to 2023, with activity picking up mostly in the second half of the year (Figure 6).

More product will come to market, as a combination of lower values and higher financing costs can make it difficult for investors to refinance, incentivising some to sell. However, there is wide variation between property types and asset quality. Most at risk will be assets acquired and financed during and in the run-up to the market peak that have seen the greatest repricing and weak rental growth.

Figure 6: Investment Volume in Europe By Sector and Forecast



Source: CBRE Research and CBRE Global Analytics & Forecasting; November 2023

03

Office

Leasing levels should pick up slowly in 2024, reflecting weak economic growth and the shift towards new workplace strategies. Vacancy levels look to be nearing a peak, with high quality new space much scarcer in many cities. Even with a slight increase in development completions, most office markets are still likely to see modest increases in prime rents.

Key Takeaways

01

Leasing volumes will likely pick up by 10% in 2024, but remain below historic norms. We anticipate employment in office-using sectors to show modest growth in 2024, and occupiers to advance their return-to-office (RTO) and workplace strategies to a point where their space needs are clearer.

02

Quality differentials will become even more apparent. The two big trends in portfolio strategy are rightsizing and quality enhancement, as occupiers act to raise the user appeal of their space and control costs. Poorer quality space will suffer higher voids and faster obsolescence, but there will be upgrading/refurbishment opportunities.

03

Vacancy rates will likely peak out in more markets. Although there may be a rise in development completions in some of the bigger markets, the flow of speculative space to the market still looks controlled. We expect most office markets to see modest growth in prime rents through 2024.

A year of slow recovery in prospect

EVOLUTION AND POLARISATION

The main influences on the office market in 2024 will be modest leasing growth, further evolution of occupiers' strategies towards hybrid working, and a deepening polarisation between prime assets and the rest.

DEMAND PICKING UP - SLOWLY

After a very weak start to 2023, leasing volumes look to have picked up a little in the second half. Despite this, the full-year figure for 2023 is likely to show a drop of 15–20%.

Looking ahead, employment in office-using sectors should see moderately positive growth in 2024. The outlook is complicated by continued restructuring in some key sectors, notably technology, where retrenchment from earlier rapid expansion will persist.

Overall, this points towards some rise in leasing demand, probably of around 10%, which would bring leasing levels back in line with 2021, but still below pre-pandemic levels.

OCCUPIER STRATEGIES: A GROWING DRIVER OF MARKETS

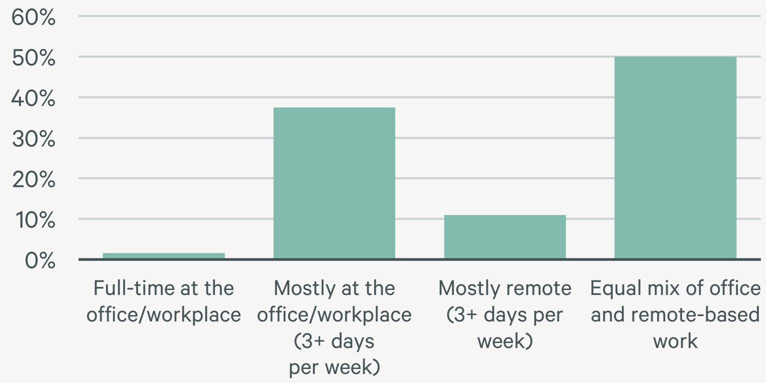
Large occupiers will be progressing their workplace strategies across a number of fronts: aiming to raise utilisation levels, rightsize portfolios, and offer quality space as part of the employee value proposition - but also tighten cost controls.

These are steps towards occupiers being able to assess their future space needs more clearly. In the short term, we see these as net negative on balance, as office attendance picks up only slowly and cost considerations dominate, hence our moderate growth expectation for leasing in 2024.

Figure 7: Office Leasing Volumes, Europe, 2015-24

Source: CBRE Research

Figure 8: Company Aspirations For Future Workplace Policy



Source: CBRE Research, European Office Occupier Sentiment Survey 2023

Companies will nonetheless be accelerating their efforts to raise utilisation levels in 2024 and move towards their target position, which is that most workers are in the office at least half the time (Figure 8).

QUALITY DIFFERENCES EXPECTED TO DEEPEN

One clear consequence is that differences between the best buildings and commodity space will likely expand through a sustained flight-to-quality. Occupier decision-making is now more motivated by factors like transport accessibility, proximity to retail, leisure, hospitality and public realm and - increasingly – sustainability.

Locations and buildings that display these features or that can be repositioned will outperform in terms of user appeal, void levels and ultimately value. Evidence of these impacts is already accumulating: the vacancy rate spread between CBD markets and overall city averages is widening in many places including Paris, Madrid, Stockholm and Amsterdam, and is likely to expand further.

DEMAND FOR FLEX SPACE TO INCREASE

Corporates' growing need for quality and agility also plays into the flex market, and we expect to see increased use of flex space within portfolios. The European flex market is still immature; we see scope for further evolution in 2024 as more occupiers become comfortable with an improving offer.

Supply side tightening for best quality space

VACANCY PEAKING OUT – DEVELOPMENT ACTIVITY TO REMAIN MUTED

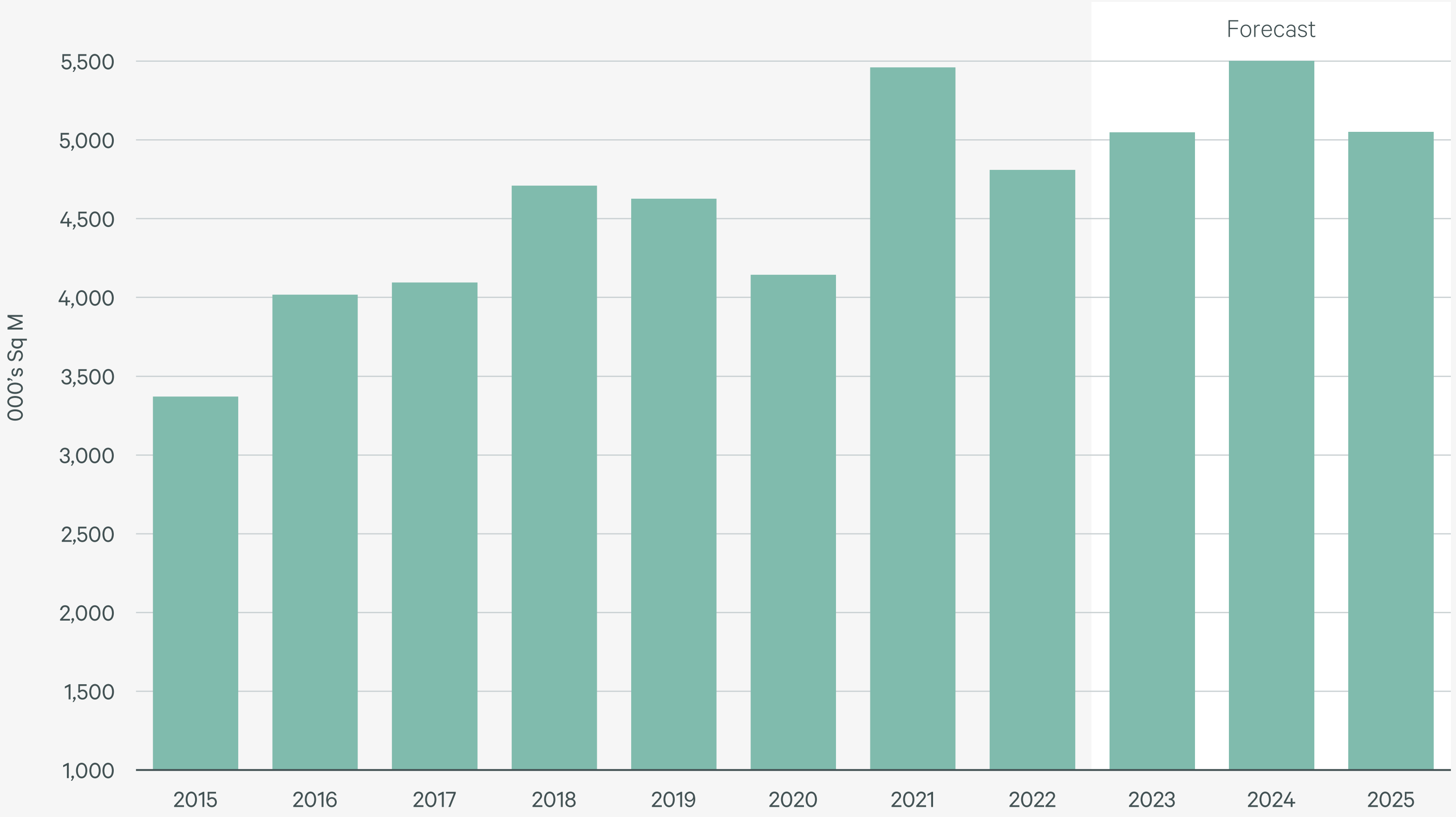
The overall vacancy rate has been rising since early 2020 and continued to do so through 2023, but there are signs of this nearing a peak in 2024. Some markets including Warsaw, Milan, and Madrid are already seeing vacancy stabilising or falling and more will follow, including major cities such as London, Paris, and Munich.

Development activity remains at generally low levels, though is likely to rise above recent levels in Western Europe, notably in Paris, Berlin, and Madrid, and up by around 10% overall. As the proportion of speculative space due for completion in the next two years is barely above 50%, occupier choice for new built space will remain tight.

MODEST RENTAL GROWTH EXPECTED

Given all this, where do we expect rents to go in 2024? So far, rents at the prime end of the market have been mostly resilient in the face of subdued demand levels, with the CBRE prime office rent index for Europe up by 4.9% in the year to Q3 2023. We expect most office markets to see at least modest growth, typically 2-3%, in prime rents through 2024, with markets such as London, Barcelona, Milan, and Amsterdam seeing the greatest increases.

Figure 9: Office Development Completions, Europe, 2015-25



Source: CBRE Research

04

Logistics

After a period of unprecedented logistics demand during the pandemic, 2023 was a tougher year. 2024 begins with the same challenges, but with expectations that the economic outlook will improve and the sector's strong fundamentals will continue to be apparent, albeit at more normalised levels.

Key Takeaways

01

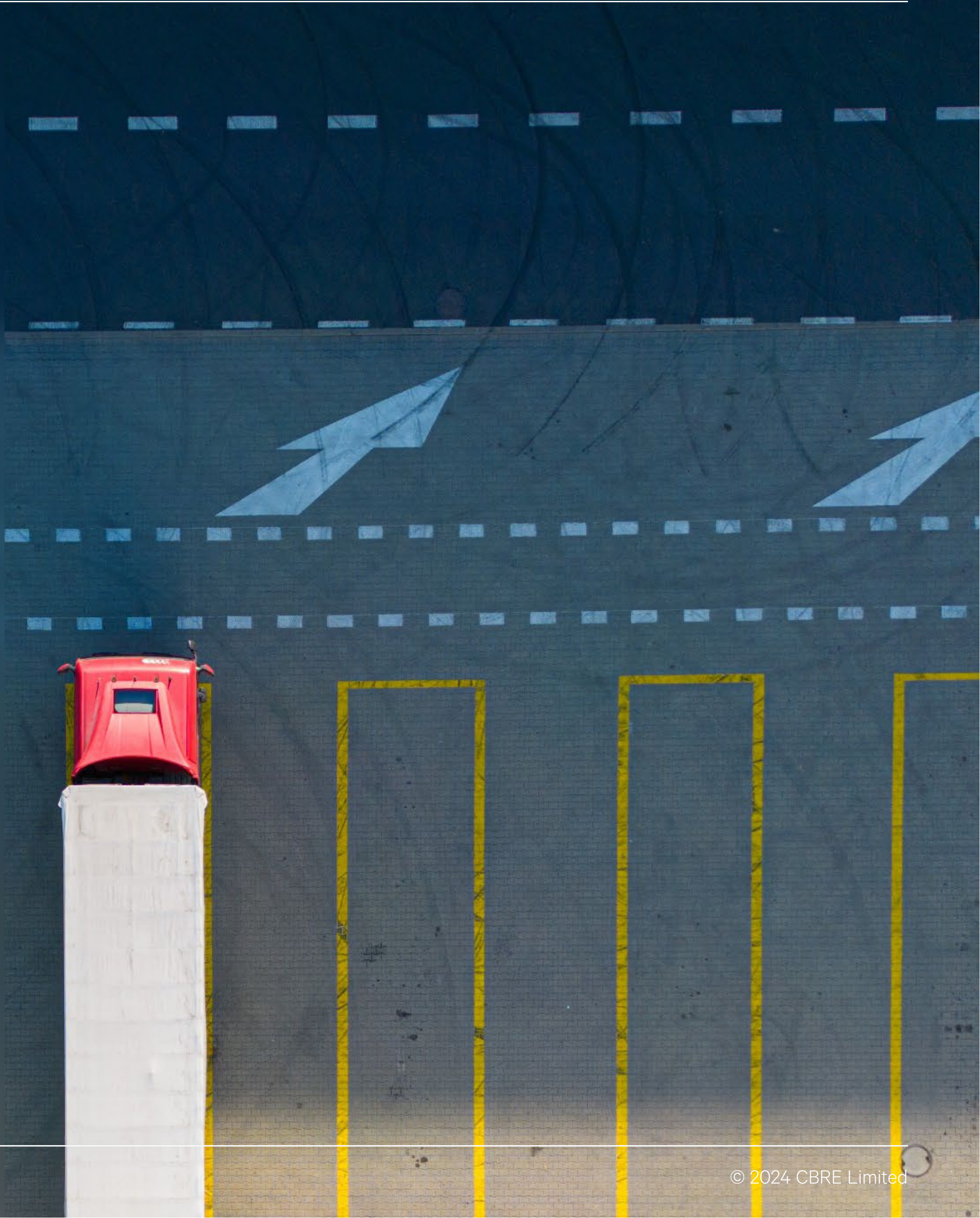
The logistics sector has seen lower take-up due to economic uncertainty and the end of the rapid expansion of online retail. Grocery and discount retailers, and manufacturers of sustainable equipment and renewable energy are expected to increase their take-up shares in 2024.

02

Developers are reacting to slower demand and the supply pipeline is thinning. Vacancy rates are expected to increase during H1 2024, before they start stabilising during the second half of the year, in most cases at levels far below the historical norm.

03

Prime rents will continue to increase, although at a more moderate rate. However, the market could become two-tiered, with an expanding gap in rents between new prime units and older second-hand buildings.



Demand to remain subdued, new stock delivery to slow down significantly

TAKE-UP TO STABILISE, REFLECTING THE MACROECONOMIC BACKDROP

There are several reasons for the significant drop in logistics take-up compared to pandemic-era levels, including ongoing economic uncertainty. However, the most important factor is the end of the extraordinary growth in logistics space needs coming from online retailers. During the pandemic, these retailers were forced to expand rapidly, occupying in a few months space it would normally take them years to acquire.

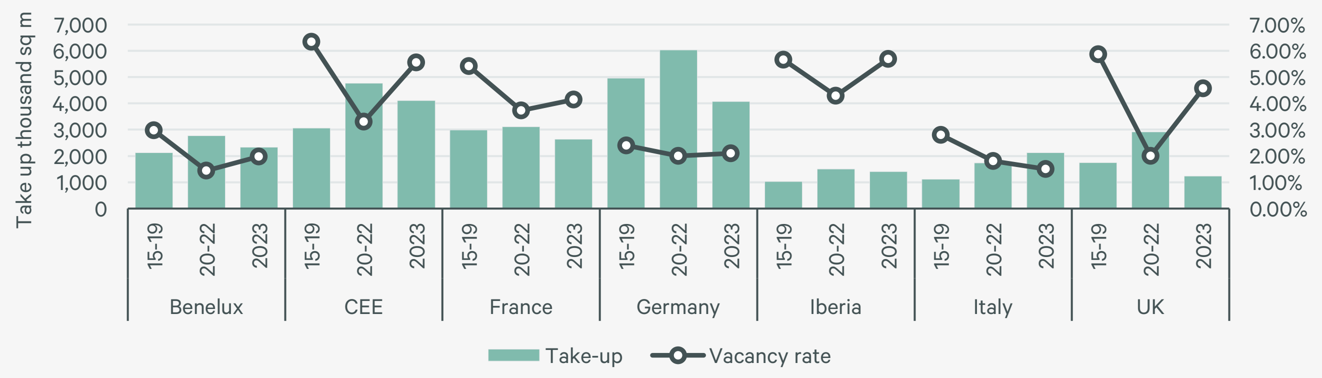
While e-commerce will keep growing, 2024 will not see a return to these sorts of growth rates. More traditional logistics sectors will see their appetite for expansion affected by the weak economic outlook. Still, we anticipate outperformance in sectors such as manufacturing, particularly from sustainability-related producers such as electric vehicle battery companies, as well as grocery and discount retailing. Outsourcing and restructuring of supply chains – including near-shoring strategies– should continue to benefit third party logistics players and boost their space requirements. However, they are now becoming much more conservative in their real estate expansion plans.

NEW SUPPLY RAPIDLY DECREASING BUT OLDER WAREHOUSES MORE CHALLENGED

While the shift has not been immediate, developers have reacted to lower demand levels by reducing construction activity. They are also facing difficult conditions, due to increases in construction and lending costs and due to the prime yields demanded by investors rising to levels that are often uneconomic for developers of new-build units. We expect the development pipeline to continue to fall. Vacancy rates have increased from the extremely low levels reached in 2022, and are expected to increase even more, but will remain significantly lower than historical averages.

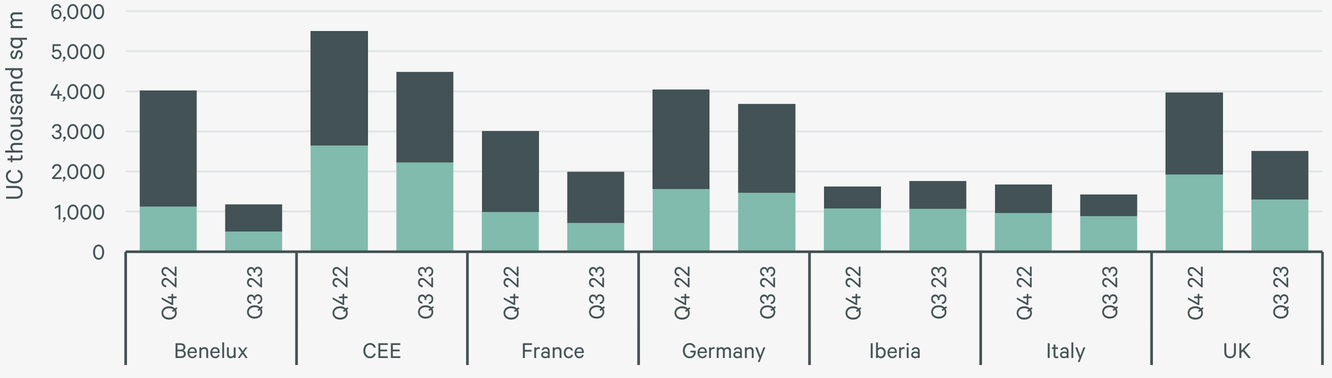
An important trend to watch during 2024 will be the change in the composition of vacant stock. Older units coming back to the market could struggle to be leased unless they undergo refurbishment to offer occupiers operational efficiencies, including new ESG features. We anticipate the rental gap between new prime units and older units to widen, effectively creating a two-tier market.

Figure 10: Q1-Q3 Logistics Take-up and Average Logistics Vacancy



Source: CBRE Research (Q1-Q3 average take-up 2015-2019 / 2020-2022 / 2023 vs vacancy rate at the end of each period)

Figure 11: Logistics Space Under Construction At The End of Q4 2022 vs End of Q3 2023



Source: CBRE Research

Note: Benelux includes Belgium and the Netherlands; CEE includes Czechia, Poland, Romania and Slovakia; Iberia includes Portugal and Spain

Prime rents still expected to grow

RENTAL GROWTH ANTICIPATED FOR THE PRIME SEGMENT

Although moderating from the double-digit growth seen in 2022, prime rents are forecasted to continue to increase by around 4% at an aggregate European level, driven by occupiers looking to maximise efficiency and comply with sustainability goals. The strongest rental growth is expected in Italy, Germany and Spain.

With inflation easing, this moderate prime rental growth in 2024 should still represent an increase in real terms, something not common for the sector before the pandemic. Nevertheless, occupiers are undertaking cost-saving measures and reviewing their real estate strategies accordingly. However, they will still need to keep the wider supply chain strategy in mind, avoiding decisions that could damage their service levels and reduce their market share.

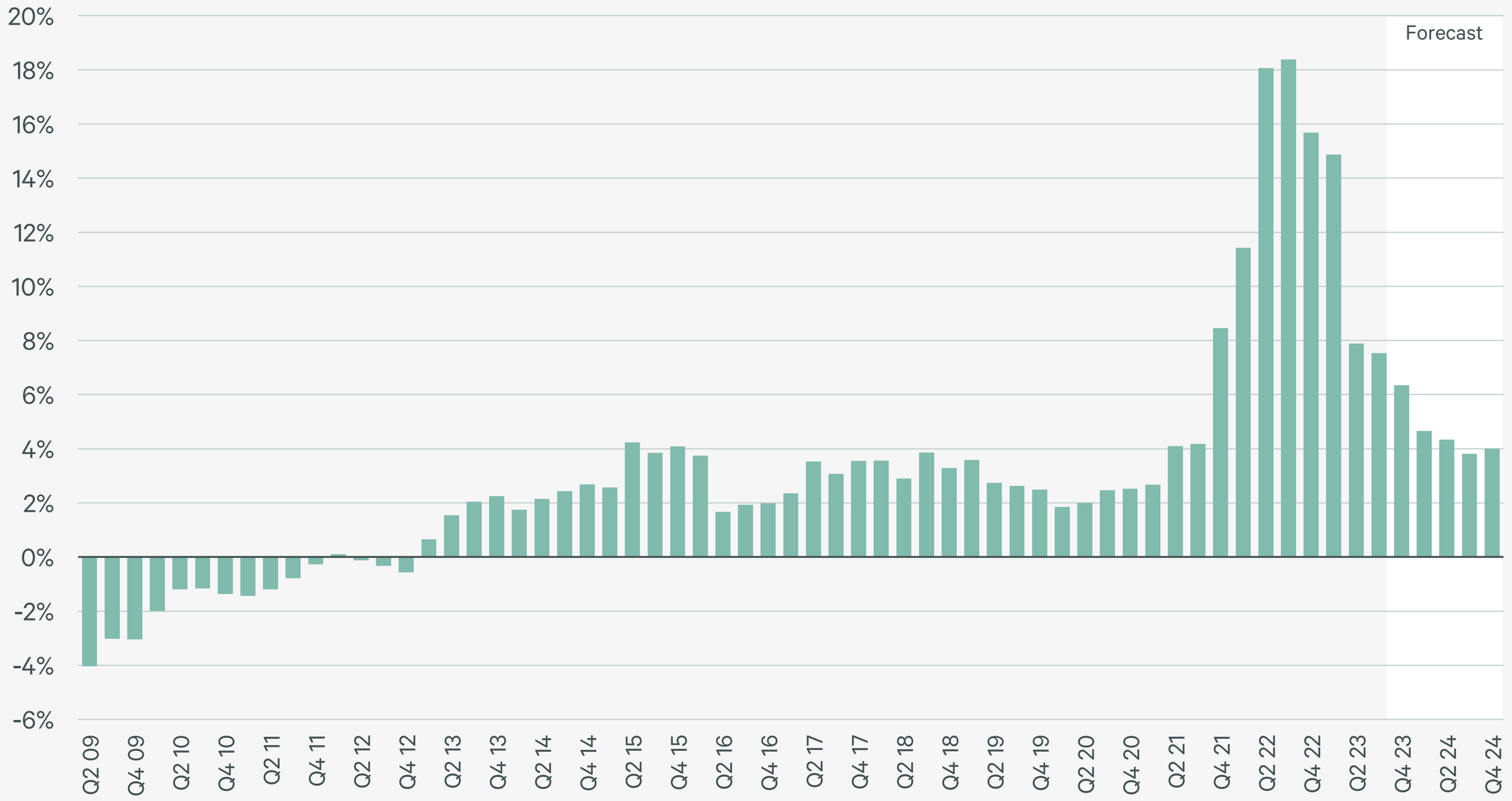
Given this background, lease incentives in the sector are expected to increase in 2024, with the magnitude of these rises closely related to the level of vacancy rates in each market.

OCCUPIER OWNERSHIP STRATEGIES

We anticipate another wave of sale-and-leaseback activity, particularly from cash-constrained occupiers, which should be well received by the investor market.

At the same time, more cash-rich occupiers could benefit from lower pricing and muted competition from developers, to secure sites and even self-develop their future warehouse needs.

Figure 12: European Annual Prime Logistics Rental Changes



Source: CBRE Research. Weighted annual average in nominal terms of the 39 prime logistics markets that CBRE forecasts in Europe

05

Living

The living sector is facing structural undersupply, with little relief in sight as developers continue to grapple with a lack of funding, lengthy planning procedures, uncertainty around exit values and more stringent regulations around sustainability. This will exacerbate the shortage of housing and put upward pressure on rents in 2024 and beyond.

Key Takeaways

01

A lack of new supply is the key theme for the living sector in 2024. Most cities are already facing a shortage of housing, and the development pipeline is expected to shrink further due to a lack of development funding, high construction costs, lengthy planning procedures and uncertainty around exit values.

02

Demand for housing across the living spectrum will remain strong, particularly in the larger European cities. This demand will be skewed towards the rental market, as an increase in mortgage rates has made renting relatively more affordable than home ownership. Despite mounting regulatory risk, an increase in market rents is expected to support solid income growth in 2024.

03

ESG will be an integral investment theme for 2024 and beyond. The European Commission’s Energy Performance of Buildings Directive gives more clarity on which sustainability targets need to be met, and when. The currently low ratings of much of the EU housing stock mean that there is a considerable challenge in renovating existing stock to meet energy efficiency standards.

Weak development activity to exacerbate pressure on affordability

URBAN POPULATION GROWTH WILL CONTINUE TO DRIVE DEMAND FOR HOUSING

Europe has seen strong population growth over the last decade, leading to an increased need for housing. Demographic trends such as an ageing population and a rise in the number of households, associated with a reduction in average household size, will continue to shape housing demand.

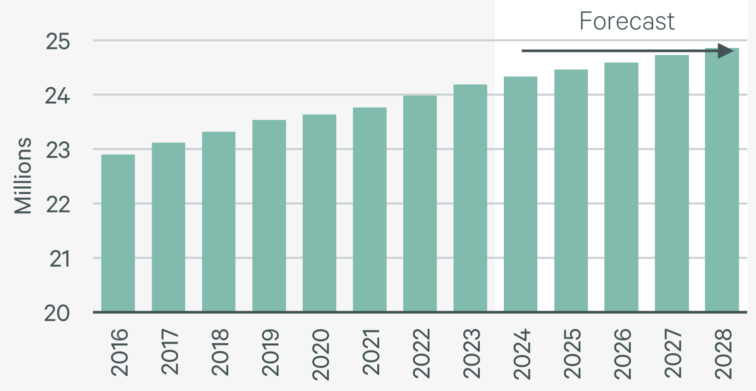
Household growth is particularly strong in large urban centres (Figure 13). In the capital cities of Europe, the number of households is expected to increase by 3% over the next five years. This will further support the demand for housing.

CONSTRUCTION COST GROWTH EASING BUT DEVELOPMENT LIKELY TO REMAIN MUTED

With demand rising, most European cities are already grappling with a shortage of new housing development. Over the last decade, construction activity was 45% below the pre-Global Financial Crisis average and supply has not been able to keep up with demand.

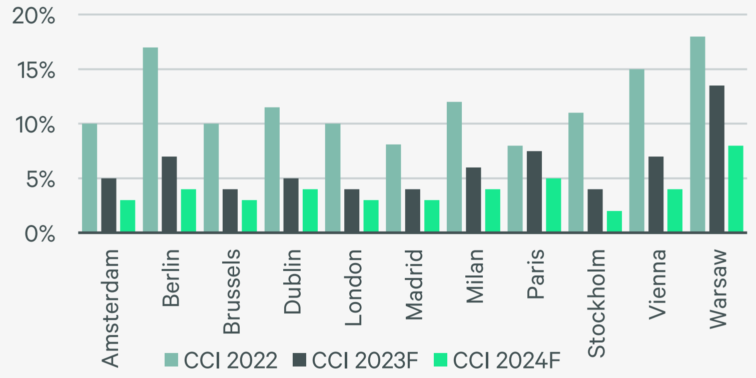
Over the last 18 months, the development pipeline has dried up further, and will remain muted in 2024. Construction cost inflation is expected to ease relative to 2023 and the spike witnessed in 2022 (Figure 14), although upward pressure on costs remains, mostly driven by an increase in wages. In addition, challenges remain for the construction sector, such as a lack of funding, lengthy planning procedures and uncertainty around exit values. This will exacerbate the supply-demand imbalance leading to more pressure on affordability.

Figure 13: Number of Households in EU & UK Capital Cities



Source: CBRE Research, Oxford Economics

Figure 14: Construction Cost Inflation in Europe



Source: CBRE Research, Turner and Townsend Construction Survey 2023

GROWING STRESS ON AFFORDABILITY LEADING TO TIGHTER REGULATIONS

The cost of living will remain elevated as higher mortgage rates reduce the affordability of home ownership, and limited new rental supply forces rents upwards. The average mortgage rate in the Eurozone and the UK is at its highest level since 2009 and is expected to stay elevated in 2024, which makes renting relatively more attractive in many markets. However, the rental segment was already overcrowded, and rising demand will push rents even higher. In some markets rent growth may reach double digits, while others are capped by rent controls. Tighter regulations however will further reduce supply. Vacancy will continue to be limited and, while regulation remains a risk, rising market rents will continue to support solid income growth in 2024.

STUDENT HOUSING AND SENIOR LIVING TO GAIN TRACTION

Strong occupier fundamentals are also visible in other segments such as student housing and senior living. As highlighted in our report, student housing demand in Europe will remain strong in 2024 as the student population – international students in particular – continues to grow. Meanwhile, the ageing population is putting pressure on senior living stock. Consequently, occupancy in these subsectors is expected to remain high in 2024, driving rental growth.

Pressure to integrate ESG practices likely to intensify

ESG EXPECTED TO BE THE KEY INVESTMENT THEME FOR YEARS TO COME

More stringent regulations to meet sustainability targets will have an impact on the living sector in 2024. According to the Energy Performance of Buildings Directive (EPBD) adopted by the European Commission, the EU's housing stock will have to achieve an EPC (energy performance certificate) rating of at least class E by 2030 and D by 2033.

As of 2023, 25% of the EU housing stock is below class E and 49% below class D[1]. While there is variation between countries, the overall challenge for the housing sector is substantial. Investors will need to plan carefully to avoid stranded assets, and demand for assets with strong ESG credentials is likely to intensify.

[1] CBRE Research based on national statistics. Energy ratings are not available for the entire housing stock. For indicative purposes we have assumed the available ratings to be representative for the whole country

06

Retail

Lower inflation and rising real wages should boost consumer fundamentals, with a positive effect on retail sales. E-commerce will grow further, but at a slower rate. Retailers will continue to explore flagship store formats in prime locations, which is expected to lead to steady prime rental growth.

Key Takeaways

01

Retail sales growth should benefit from falling inflation rates and rising real incomes. Footfall and sales at key retail assets are expected to continue their upward trajectory. The lagged effect of earlier interest rate rises remains a downside risk.

02

E-commerce growth is expected to continue, but at a more moderate rate than during the pandemic. Major European markets are expected to grow in line with their pre-pandemic trend, with no accelerated growth.

03

Rental growth is expected to continue, with the rate exceeding inflation in the second half of 2024. Occupiers will likely continue their investment in physical stores, focusing more on prime locations.

Retail fundamentals expected to improve in 2024

CONSUMER FUNDAMENTALS LIKELY TO IMPROVE DUE TO RISING REAL INCOMES

Real wage growth has been in negative territory across the UK and Euro area since the end of 2021, as high inflation has eroded purchasing power. However, it is anticipated to have returned to positive levels in late 2023, and to continue to improve in 2024 as inflation softens.

This in turn will likely have a positive impact on retail sales volumes, which have already proven to be resilient in the face of recent economic headwinds. While consumer confidence fell sharply following the outbreak of the war in Ukraine, retail sales across the Euro area held up and, despite their mild downward trend in 2023, remain above December 2019 levels in real terms. Retail sales are below end-2019 levels in the UK in real terms, though are forecast to improve in 2024.

The growth in purchasing power is expected to have a positive effect on retail fundamentals. Nevertheless, the lagged effect of interest rates rises remains a downside risk.

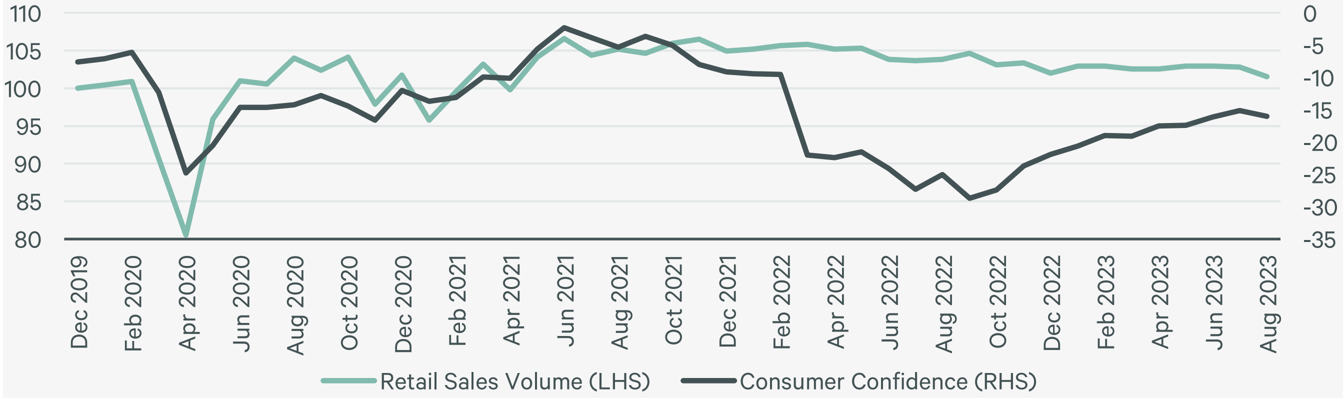
E-COMMERCE GROWTH TO CONTINUE, BUT AT A SLOWER RATE

The pandemic led to a surge in the share of retail sales occurring online as opposed to in-store. However, following the re-opening of physical retail, e-commerce penetration moderated.

CBRE's recent analysis of post-pandemic e-commerce trends found that for key European markets, e-commerce penetration has broadly returned to its pre-pandemic growth trend. There has been little or no sustained acceleration of the growth rate as a result of the pandemic.

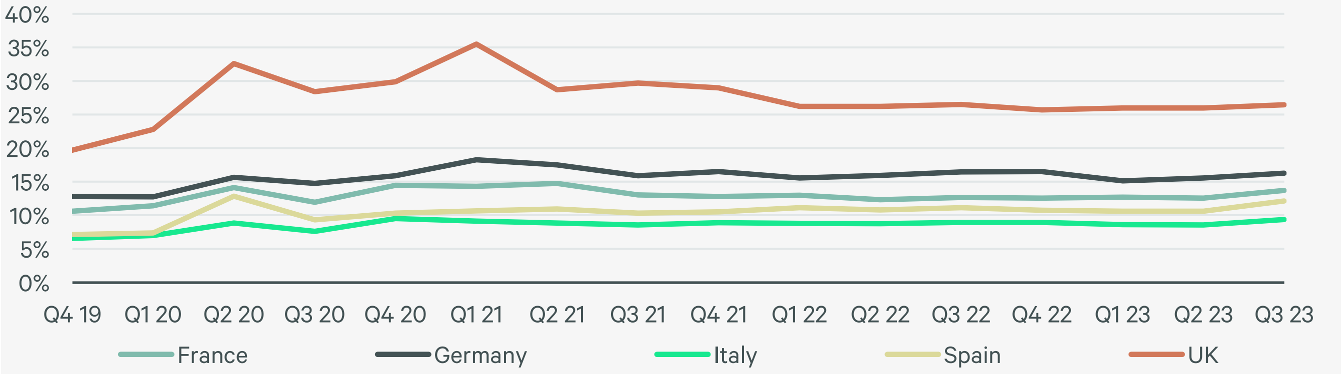
CBRE expects e-commerce to continue to grow in 2024, but broadly following this pre-pandemic trajectory. Occupiers are likely to continue to focus on creating a strong omnichannel experience, which seamlessly combines the online and brick-and-mortar experience and increases customer engagement.

Figure 15: Euro Area Retail Sales Volume Index (12/2019=100) and Consumer Confidence Balance



Source: Eurostat, Macrobond, CBRE Research

Figure 16: E-commerce Penetration Rates, Selected European Markets (%)



Source: CBRE Research, Euromonitor, Eurostat, Forrester, Istat, ONS

Sales and footfall to continue to improve, generating growth in prime rents

FOOTFALL AND TURNOVER LEVELS ARE EXPECTED TO CONTINUE IMPROVING

The improvement in consumer fundamentals is already having a positive effect on retail footfall, with footfall at CBRE's managed portfolio of European retail assets now within 3% of pre-pandemic levels as of late 2023. We expect the upward trend to continue, and for footfall to return to, or exceed, pre-pandemic levels in 2024. Sales values are already above pre-pandemic levels and are expected to continue their upward trend.

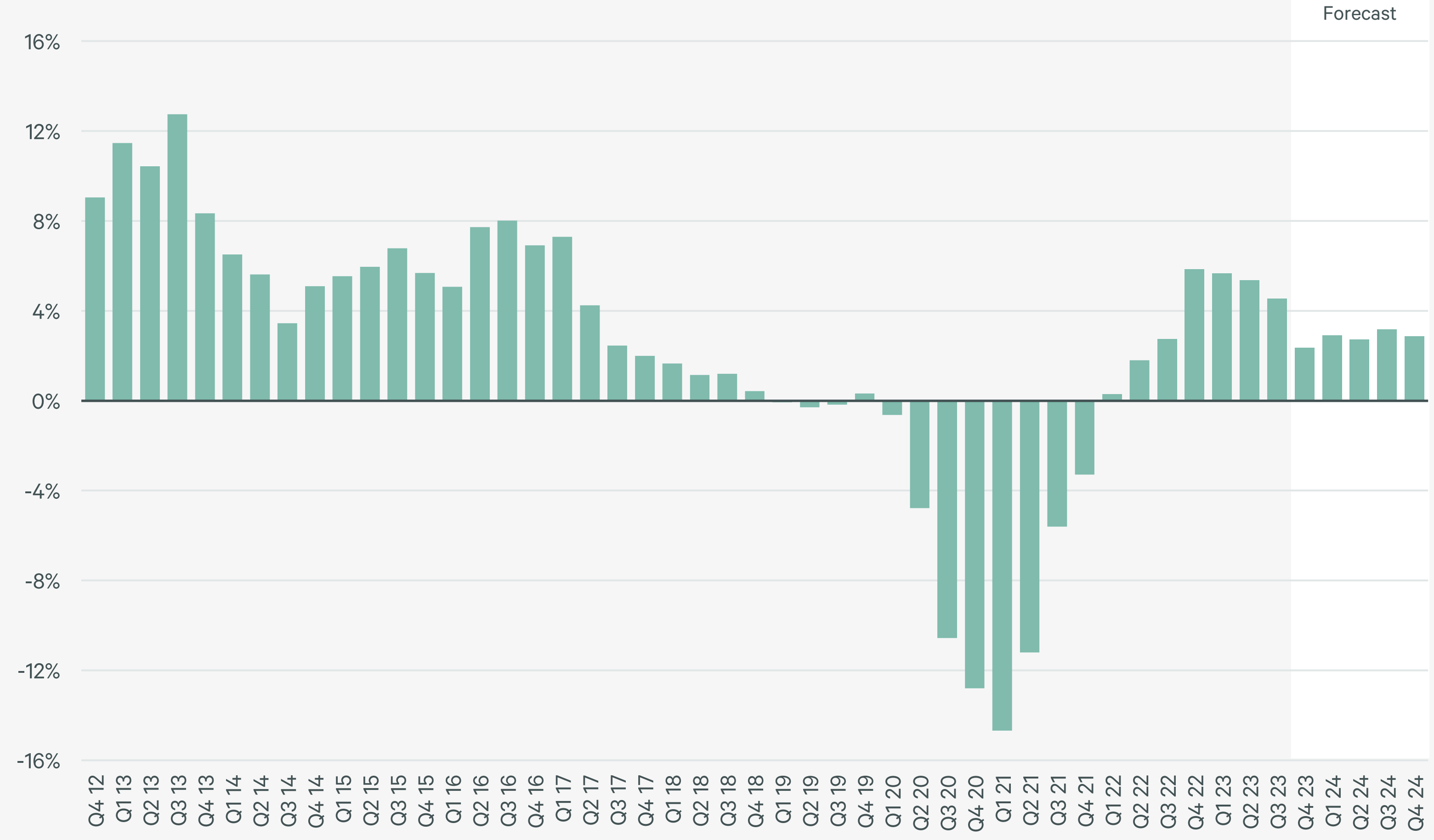
It is likely that convenience-focused retail assets will continue to perform strongly, with a similarly positive performance from dominant, experience-focused shopping centres that have a strong leisure and food and beverage offer.

PRIME RENTAL GROWTH ANTICIPATED DUE TO STRONGER FUNDAMENTALS

An improvement in demand drivers for the retail sector is expected to have a positive impact on prime rents, which are expected to grow at around 3% in Europe in 2024, returning to positive growth in real terms in the second half of the year as inflation falls.

The polarisation between prime and secondary assets is likely to continue, with the most robust rental growth and occupier demand focused on those locations best suited to serving their catchment with the strongest proposition. Retailers are expected to continue investing in physical stores, focusing more on these prime locations.

Figure 17: Top European Retail Locations Prime Rental Growth and Forecast (% p.a.)



Source: CBRE forecast (weighted average of top European retail markets, 60/40 high street/shopping centre split)

07

Hotel

Europe's hotel and tourism sector is poised to gain further momentum in 2024. This is driven by a rise in leisure travel, including from Asian markets, and a more gradual recovery of corporate and group travel. After outsized growth of 20% in 2023, Revenue Per Available Room (RevPAR) in 2024 is expected to increase at a brisk but more moderate rate in the high single-digits.

Key Takeaways

01

Domestic and short-haul leisure travel will continue to be the primary driving forces for hotel demand. There is also an upside from international long-haul leisure travel from Asian markets, supported by a gradual revival of travellers from China and Japan, which had been lagging.

02

Growth in Revenue per Available Room (RevPAR) is likely to ease to a high single-digit rate in 2024. This indicates a return to more normalised levels of demand growth. Given the outlook for sustained demand and moderating inflation, we expect 2024 to be another year of both profit increases and margin expansion.

03

We expect hotel demand growth to outpace supply given recent increases in construction and borrowing costs. This difference is likely to be most marked in popular tourism locations that already offer prime hotel space, and where demand will remain robust.

Continued recovery in international long-haul leisure travel

PROPELLING HOTEL DEMAND THROUGH MAJOR EVENTS

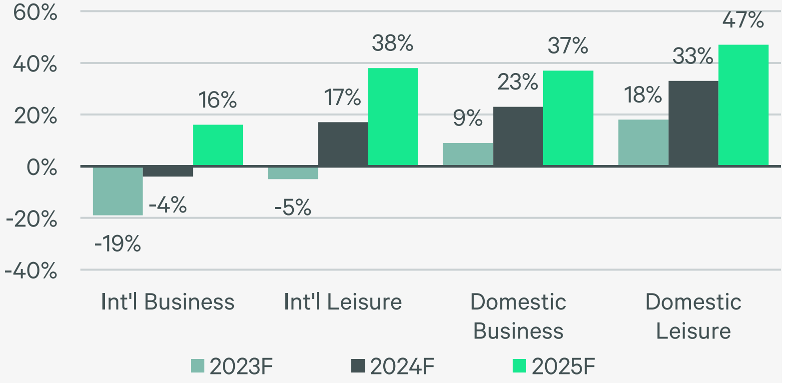
Europe's hotel and tourism sector continues its journey to full recovery, primarily driven by domestic and intra-regional leisure travel.

International leisure travel is expected to stage a meaningful recovery in 2024. The addback of long-haul flights from Asia Pacific should help support the improvement in international leisure demand.

Business travel, particularly international long-haul, is expected to show meaningful year-over-year growth, but is likely to lag leisure due to the delay in returning to the office in some markets and the ongoing prevalence of virtual meetings.

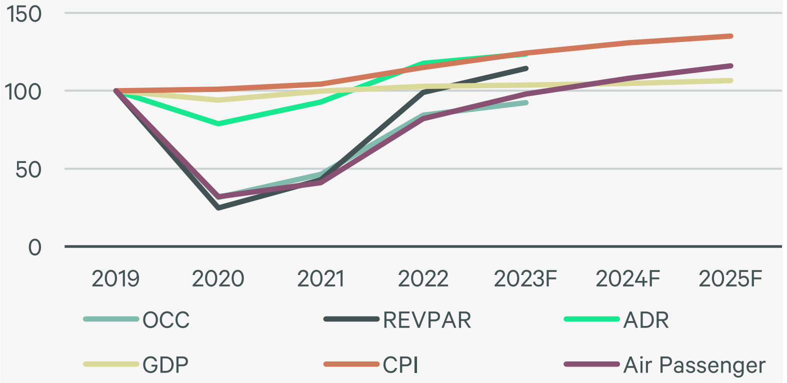
Several major sporting and entertainment events are expected to further operators' ability to increase room rates and raise occupancy in the hosting cities. These include the 2024 Paris Summer Olympics and UEFA Euro 2024 in Germany, as well as major music tours by artists such as Coldplay and Taylor Swift.

Figure 18: Europe - International Arrivals (% relative to 2019)



Source: Tourism Economics, CBRE Research

Figure 19: Europe - Performance & Key Indicators (2019=100)



Source: HotStats, Oxford Economics, IATA, CBRE Research

The conflicts in Ukraine and the Near East may cause some travellers to shift their travel plans to Northern and Western Europe, as was seen during prior periods of conflict. As these are generally higher ADR markets, this shift could be yet another catalyst for occupancy growth and rate compression during peak periods.

REVPAR GROWTH WILL CONTINUE TO MODERATE

After enjoying strong gains fuelled by inflation and surging demand in 2023, the pace of gains from an operator's perspective is likely to moderate. We expect RevPAR growth in 2024 to decelerate to a high single-digit rate.

Throughout the pandemic, operators demonstrated their ability to adapt quickly to changing market conditions, leading to improved operational efficiency. This is set to position them well to maintain profitability in the face of potentially challenging economic conditions ahead.

The luxury and resort segments are expected to continue performing better relative to other segments. The key drivers - strong wealth creation and consumer demand from high-income groups – are less vulnerable to macroeconomic headwinds.

1. Source: Tourism Economics

Favourable supply and demand dynamics anticipated

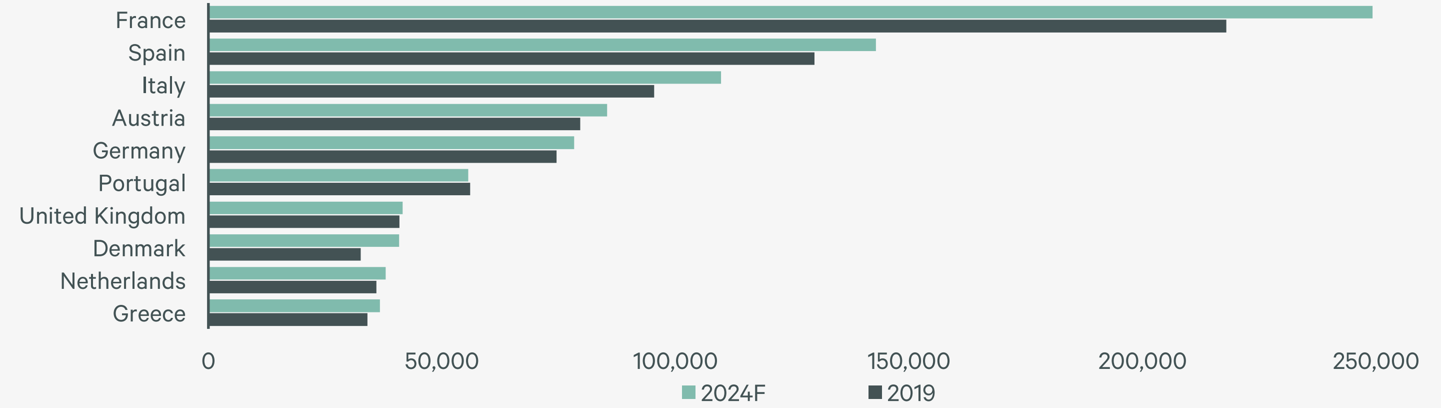
GROWTH IN VISITOR ARRIVALS TO OUTPACE SUPPLY GROWTH

From 2009 to 2022, overall European hotel supply grew at a 1.4% compound annual growth rate (CAGR). Beginning in 2024, supply growth is expected to moderate to just a 1% CAGR, well below the estimated 3% annual growth in visitor arrivals supporting further RevPAR gains.

The UK and Germany are at the forefront of European hotel developments. Between them, they account for over a third of the total hotel pipeline from 2024 to 2028, and hence they will experience above-average rates of supply growth.

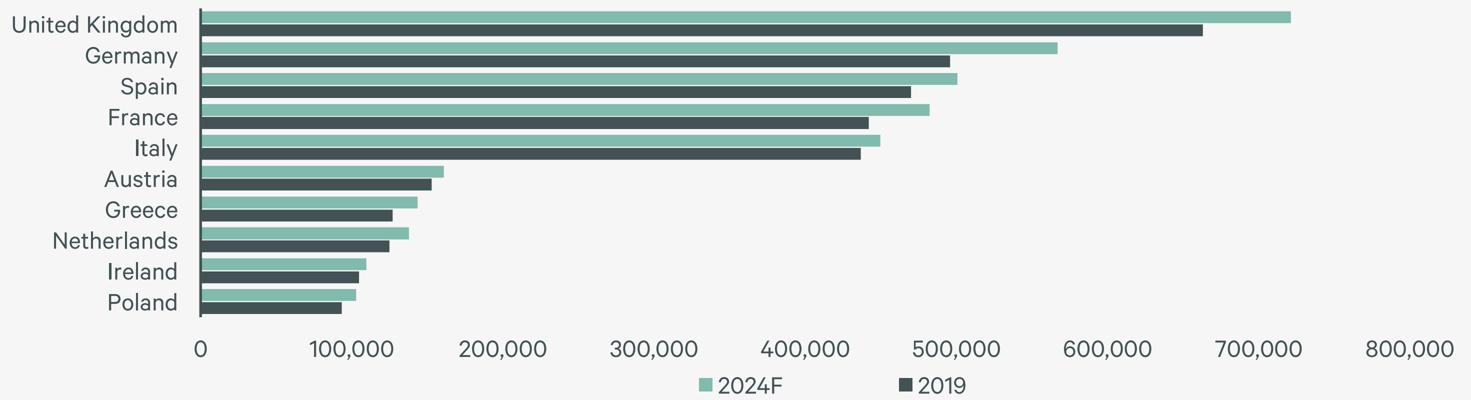
Other markets may see a more favourable supply and demand balance. France, Spain and Italy are particular bright spots, and are forecast to see a relatively low level of new hotel development and the highest number of international inbound visitors in 2024 and beyond. This highlights the potential for further gains in RevPAR and operating income in these markets and supports their position as attractive investment targets.

Figure 20: Top 10 European Countries: Total international inbound visitor arrivals ('000)



Source: Tourism Economics, UNWTO, CBRE Research

Figure 21: Top 10 European Countries: Total overnights stays in all accommodation ('000)



Source: Tourism Economics, CBRE Research

08

Data Centres

Demand for capacity in Europe is high, though a lack of available power across metro markets is expected to inhibit growth to varying degrees. Some organisations are likely to look for capacity in new areas where supply can be more easily sourced, and the cost of power is lower.

Key Takeaways

01

Strong demand from hyperscalers is expected to push data centre take-up to new highs in 2024. Vacancy rates are likely to fall to record lows across Europe's largest markets.

02

Colocation data centre providers will likely hike rental rates further, given the lack of supply as well as the rising development and operational costs. Given an expected decline in available space, organisations are likely to seek capacity in facilities that are further from existing well-developed data centre markets.

03

A lack of available power in European metro markets is expected to inhibit the growth of data centre providers looking to meet the needs of the hyperscalers who are their largest customers.

Appetite for data centre space expected to remain strong despite higher rates

DEMAND ACROSS EUROPE EXPECTED TO HIT NEW HIGH

Most data centres are entirely pre-let to hyperscalers or are built with them in mind. Strong demand for capacity by hyperscalers is expected to push data centre take-up to a new peak (667MW) in 2024.

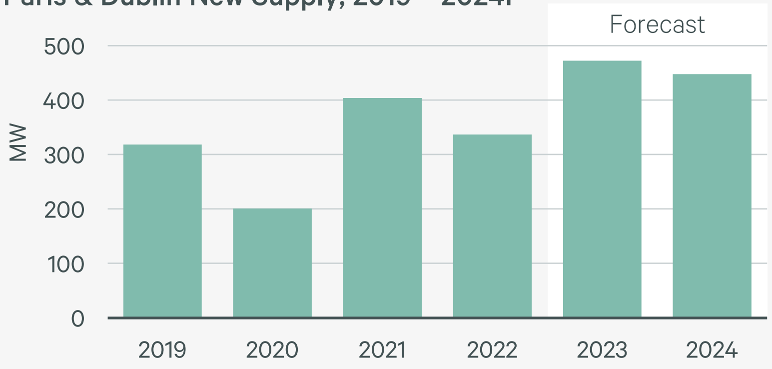
Large American technology companies need more capacity to ensure that future demand for their digital services can be met. Much of the next year's take-up will be from hyperscalers looking for capacity in the submarkets where they already have a significant presence, such as Sossenheim in Frankfurt or the north of Paris.

At the same time, providers' continued difficulties in bringing new facilities online are expected to lead the European vacancy rate to an all-time low of 10.7% in 2024.

EXCEPTIONAL RENTAL RATE GROWTH EXPECTED

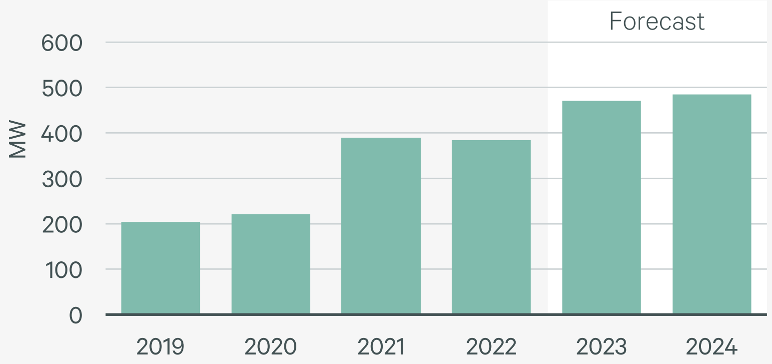
The combination of lower available capacity across Europe, as well as higher build and operational costs, makes it almost inevitable for providers to increase rental rates at colocation data centres in 2024. We expect rents for occupiers to reach new heights in 2024.

Figure 22: Frankfurt, London, Amsterdam, Paris & Dublin New Supply, 2019 – 2024F



Source: CBRE Research

Figure 23: Frankfurt, London, Amsterdam, Paris & Dublin Take-up, 2019 – 2024F



Source: CBRE Research

DEMAND FOR AI REQUIREMENTS EXPECTED TO EMERGE

Data centre providers in 2024 are likely to see an uptick in requests for capacity from companies with artificial intelligence (AI) requirements. These are expected to come mostly from well-funded technology service providers and AI start-ups, as opposed to hyperscalers. The former group are wholly dedicated to the provision of services based on AI technology and therefore need large-scale capacity immediately. The latter group are still exploring their requirements relative to their IT strategies and are therefore expected to take longer to issue AI-specific requirements.

MORE ORGANISATIONS EXPECTED TO LOOK FURTHER AFIELD FOR CAPACITY

More organisations are likely to take capacity in areas where supply can be more easily sourced and the cost per kWh is lower. Enterprises are having a particularly difficult time sourcing new capacity, as most of it is taken by hyperscalers before it is delivered. However, enterprises may find uncontracted and suitable supply, that is undesirable to hyperscalers, further afield.

09

Sustainability

As the push to net zero accelerates in Europe, failure to implement changes to accommodate these goals could soon become a business liability. Look for occupiers, developers and investors to seek closer alignment in their ESG priorities, goals and timeframes.

Key Takeaways

01

Decarbonising the built environment plays an increasingly key role in climate change mitigation strategies. Occupiers, developers and investors are likely to seek further urgent alignment in their priorities, ESG goals and timeframes.

02

With carbon-intensive assets at risk of value depreciation, we expect growth in incentives and strategies for financing retrofit and refurbishment. The transition towards renewable energy sources should also accelerate.

03

Leveraging technology and digital solutions to automate data collection is becoming essential, to overcome deficiencies in the availability of quality data. Social value of real estate, biodiversity and Artificial Intelligence (AI) are expected to be some of the most important emerging trends in the year ahead.

Market preferences evolve as awareness of climate change grows

ASSET REPOSITIONING CREATES OPPORTUNITIES

Net zero commitments, coupled with structural change in occupier fundamentals, will increasingly lead to occupiers targeting assets with good sustainability features and/or better energy performance. More importantly, occupiers show a willingness to pay rent premiums to switch to green energy, as well as for assets with sustainability certifications (Figure 24).

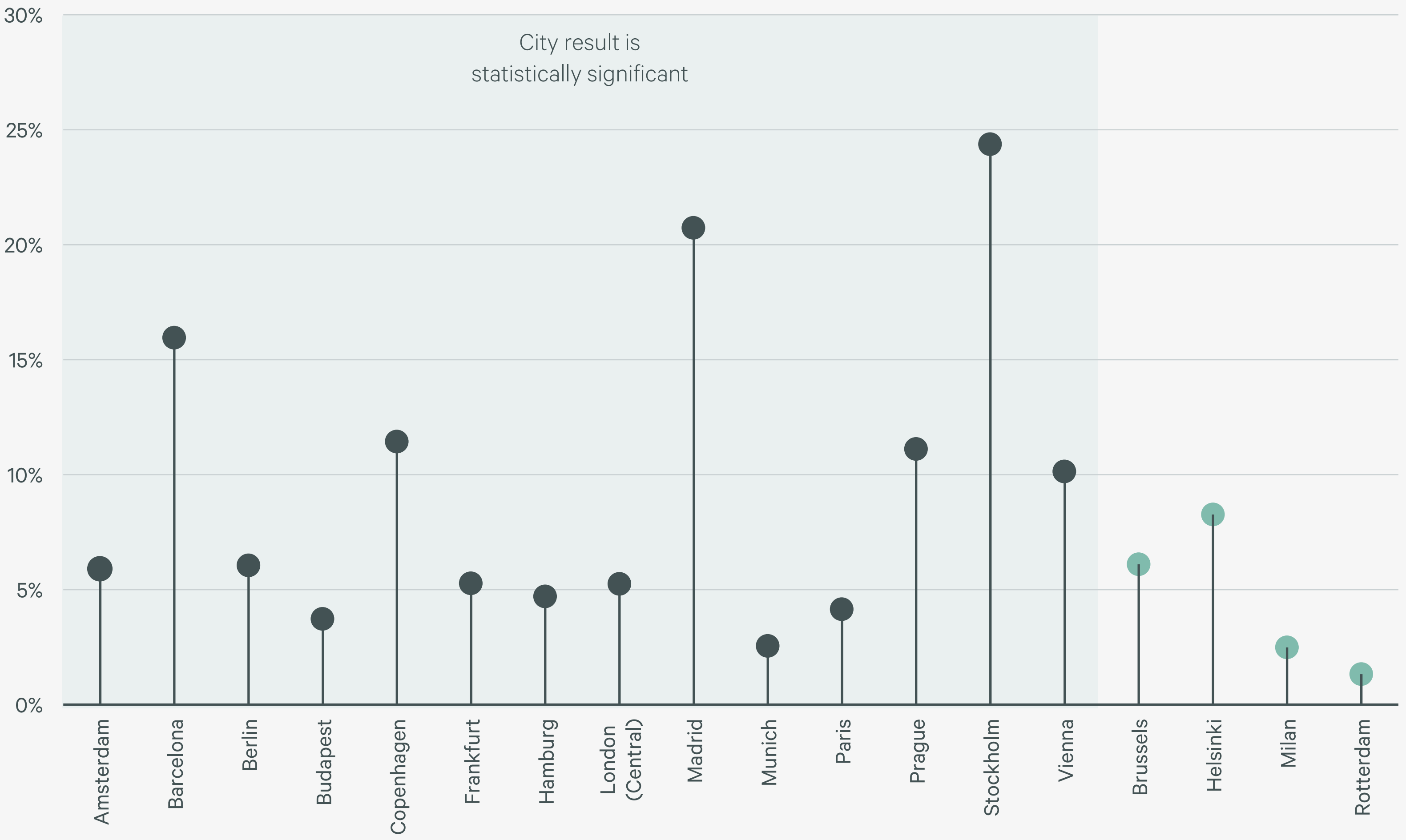
However, occupiers' ability to deliver on their commitments will be dependent on the availability of adequate real estate. As some assets are more costly to decarbonise, investors will continue to view the capital expenditure as an additional risk to investment returns. However, investing in retrofitting assets that do not meet occupier requirements creates the opportunity to benefit from repositioning early in the transition.

FOCUS ON RENEWABLE ENERGY SOURCES INTENSIFIES

By 2030, the European Commission expects solar energy to be the largest energy source in the EU, with more than half coming from rooftops. Incentives and strategies for financing renewable energy transition are therefore expected to be increasingly introduced in European markets.

Besides addressing the challenge of energy security and energy poverty, solar energy will contribute to reducing greenhouse gas (GHG) emissions and therefore limit real estate assets' contribution to climate change. From an occupier perspective, solar systems will be a way to reduce the cost of occupancy. For investors and property owners, installation of on-site solar energy production will provide opportunities for asset value uplift (CBRE, 2023).

Figure 24: Rental Premium for Certified Offices



Source: CBRE Research

Market preferences evolve as awareness of climate change grows

ACCESS TO QUALITY DATA IS TRANSFORMATIVE

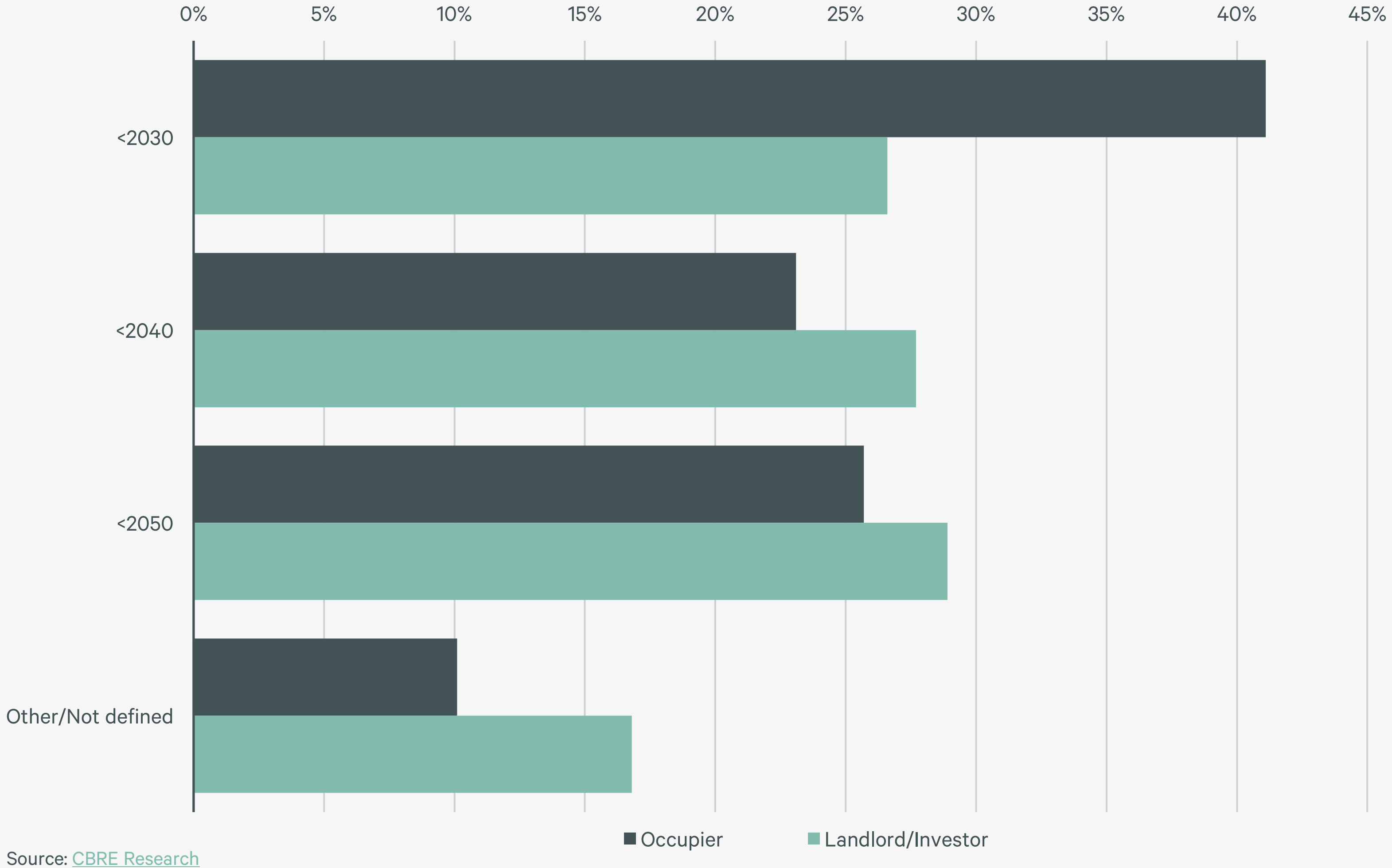
Further digitisation of data collection and analysis processes will enhance stakeholders' visibility of the costs and benefits of sustainability initiatives, and therefore lead to better-informed decisions. The ability to demonstrate a return on investment and increased profitability linked to sustainability initiatives will support investors' and property owners' efforts to protect the value of their assets. Going forward, technology will increasingly be leveraged at scale, giving a competitive advantage to early adopters.

01 Social building features that focus on tenant benefits are expected to increasingly affect the value of real estate transactions.

02 Following the adoption of the Nature Protection Law, one of the core pillars of the European Green Deal, the role of biodiversity in creating environmental, economic and social value for real estate will come to the fore.

03 Finally, Artificial Intelligence (AI) will add another layer to the transformation of real estate. Data centres, being the critical infrastructure behind the digital economy, have the potential to grow rapidly. However, the sustainability of power grids will also need to be secured.

Figure 25: Date Set For Achieving Organisation's Net Zero Pledge (Continental Europe)



Source: CBRE Research

Contacts

European Research

Tasos Vezyridis
Executive Director,
Head of Thought Leadership for Europe
tasos.vezyridis@cbre.com

Richard Holberton
Senior Director, Office Occupier Research, Europe
richard.holberton@cbre.com

Dragana Marina
Senior Director, ESG Research, Europe
dragana.marina@cbre.com

Raphael Rietema
Director, Capital Markets & Residential Research, Europe
raphael.rietema@cbre.com

Pol Marfà
Director, Retail & Logistics Research, Europe
pol.marfamiro@cbre.com

Kevin Restivo
Director, Data Centre Solutions Consulting, Europe
kevin.restivo@cbre.com

Ronald Chan
Associate Director, Hotels Research, Europe
ronald.chan@cbre.com.hk

Benjamin Pipernos
Senior Analyst, Capital Markets Research, Europe
benjamin.pipernos@cbre.fr

Alex Ozga
Senior Analyst, Retail & Logistics Research, Europe
alex.ozga@cbre.com

Fraser Daisley
Senior Analyst, Office Investor Research, Europe
fraser.daisley@cbre.com

Ali Naqvi
Analyst, Residential Research, Europe
ali.naqvi@cbre.com

Neil Blake, Ph.D.
Global Head of Forecasting & Analytics,
Europe Chief Economist
neil.blake@cbre.com

Ruth Hollies
Senior Director, Head of European Forecasting
ruth.hollies@cbre.com

Global Research Leadership

Richard Barkham
Global Chief Economist,
Head of Global Research & Americas Research
richard.barkham@cbre.com

Julie Whelan
Global Head of Occupier
Thought Leadership & Research Consulting
julie.whelan@cbre.com

Henry Chin, Ph.D.
Global Head of Investor Thought Leadership,
Head of Research, APAC
henry.chin@cbre.com.hk

Jos Tromp
Head of Research & Data Intelligence, Continental Europe
Head of Business Development, Continental Europe
jos.tromp@cbre.com

Jennet Siebrits
Head of UK Research
jen.siebrits@cbre.com

CBRE

Contacts

Business Contacts

Chris Brett
Head of Capital Markets, Europe
chris.brett@cbre.com

Guy Holden
Managing Director,
Advisory & Transaction Services, Europe
guy.holden@cbre.com

Nick Hendy
Managing Director,
Head of Office Investment Properties, Europe
nicholas.hendy@cbre.com

Jack Cox
Managing Director, Head of Industrial & Logistics Capital Markets, Europe
jack.d.cox@cbre.com

Mark Cartlich
Senior Director, Head of Strategy
Industrial & Logistics Capital Markets, Europe
mark.cartlich@cbre.com

Jeremy Eddy
Managing Director, Living Capital Markets, Europe
jeremy.eddy@cbre.com

Chris Gardener
Managing Director, Capital Markets & Head of Retail, Europe
chris.gardener@cbre.com

David Close
Executive Director,
Head of Occupier Retail, Europe
david.close@cbre.com

Kenneth Hatton
Head of Hotels, Europe
kenneth.hatton@cbrehotels.com

Andrew Jay
Head of Europe Data Centre Solutions
andrew.jay@cbre.com

Kevin Restivo
Director, Data Centre Solutions Consulting, Europe
kevin.restivo@cbre.com

Ludovic Chambe
Head of ESG & Sustainability Services, Continental Europe
ludovic.chambe@cbre.com

Ella Etienne-Denoy
Head of ESG, Business Development & Innovation, Continental Europe
ella.etiennedenoy@cbre.fr

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