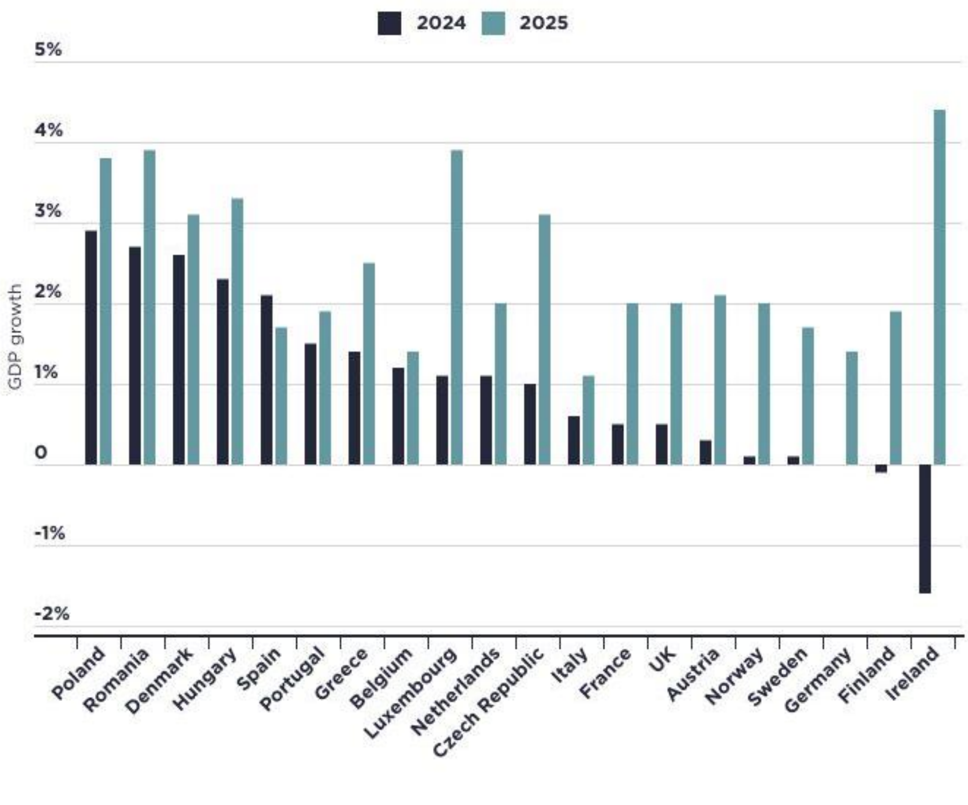
European Property Markets Have Probably Bottomed Already

On the 31st of July 2024 the Bank of England ("BoE") voted to lower the Bank Rate by 25 bps to 5%, following a similar decision made by the European Central Bank ("ECB") in June. This finally signals a significant shift in the stance of central banks after well over 2 years of tight monetary policy. With euro area inflation continuing to recede, down from its October 2022 highs of 10.6% to just 2.6% now, we expect the ECB to continue gradually easing rates towards a forecasted 2.0% by the end of 2025.

2024 has also been a historic year as 2 billion voters across 50 countries will head to the polls, the most in history. An exciting year for democracy, but less so for the markets, which rarely flourish during uncertainty. Now, as the UK general election, European Parliament election and many other elections have passed, the political backdrop will begin to stabilise, and investor confidence should return.

The economy too looks like it could be turning a corner, with the eurozone demonstrating modest yet promising growth as depicted in Figure 1. Forecasts suggest that the region's GDP will expand by 0.7% in 2024, and 1.2% in 2025.



Source: Savills Research based on Oxford Economics

Figure 1 – Forecasted annual GDP growth

So, what does this mean for real estate investors?

The confluence of the above factors will likely lead to improved optimism and a bottoming in property valuations. Just last month, German multi-family residential behemoth and Europe's largest real estate company, Vonovia, gave a confident assessment that their valuations had bottomed out. Barings too has written about the trough in the property cycle which they believe passed when peak inflation and rate volatility hit in mid-2023 - see Figure 2 on the next page.

Figure 2 – European property cycle

We expect the more optimistic environment and improving debt market conditions to result in a gradual recovery in investment activity in Europe – see Figure 3. For example, Derwent London, one of our portfolio holdings, recently sold the Turnmill Building to Titan Investors for £77.4m. A small premium over its December 2023 valuation. More importantly though, this transaction represents the largest investment deal in the London office market in the first half of 2024. The first time since 1999 that not a single transaction over £100m was completed in the first half of the year. Historically, there has been an average of 15 transactions of this size over the same period. A stark depiction of the extent to which large transactions have slowed due to the higher cost of capital.

Now though, with the first of several rate cuts already performed and the rising availability of leverage, transactional activity is already showing signs of picking up, as two London office buildings are under offer at values exceeding £100m in the second half of 2024.

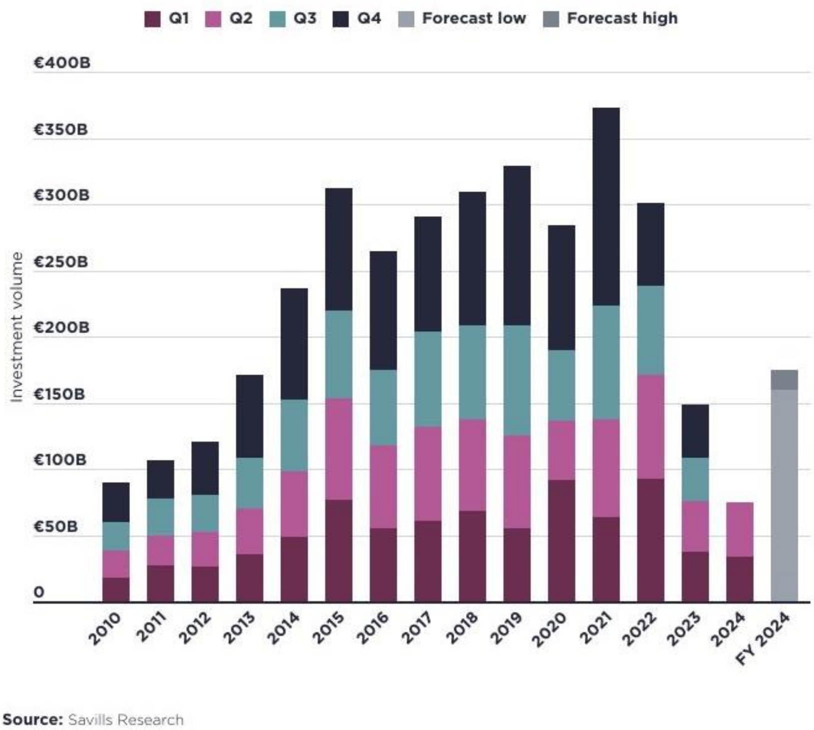


Figure 3 – European investment volumes are forecast to tick up

Now is the time for stock pickers

Since their mid-2022 peak, Parisian office values have dropped by 29% – see Figure 4. Interestingly, prime centrally located assets fell less than 10%. While lower quality properties plummeted more than 39%. This trend is creating a polarisation in the market, where premium, ESG credentialed buildings are markedly outperforming lower-quality assets.

Source: Immostat

Figure 4 – Greater Paris office values per square meter

Indicating that investors are remaining selective, targeting assets that provide the highest return through strong profit growth and favourable supply and demand fundamentals. In this environment, investors with an in-depth knowledge of the underlying properties and their fundamentals will likely outperform.

We believe logistics is a sector with promising fundamentals. Poised to benefit from increasing consumer spend, a result of falling inflation and interest rates. Whether that spend is in physical retail spaces or on e-commerce platforms rising consumption boosts industrial occupier activity. With 20% of the Camino fund invested in the industrial sector, the portfolio is well positioned to benefit.

Investment takeaways

Investing towards the end of a business cycle is often challenging. While writing about the transition from one phase of the cycle to the next is easy, positioning a portfolio for the anticipated transition is somewhat trickier. While the future is always unknown, astute investors can position their portfolios to benefit from what we believe are trough valuations in the European real estate market.

To learn more about this unique entry point into the property market and the Clearance Camino fund please join us on the 11th of September 2024, 10:00 via Zoom. Click here to register.

Visit us at www.clearancecaminofund.com.