

EUROPE

2025 Real Estate Outlook

Investment Research

EXECUTIVE SUMMARY

Europe

Total returns in Europe have turned positive and are set to improve further on the back of stable yields and ongoing rental growth.

Liquidity is still low but is set to pick up significantly in 2025 as interest rates fall further and investor sentiment picks up.

There is a broad set of investment opportunities driven by rising values from a low base, ongoing low supply and structural demand growth.

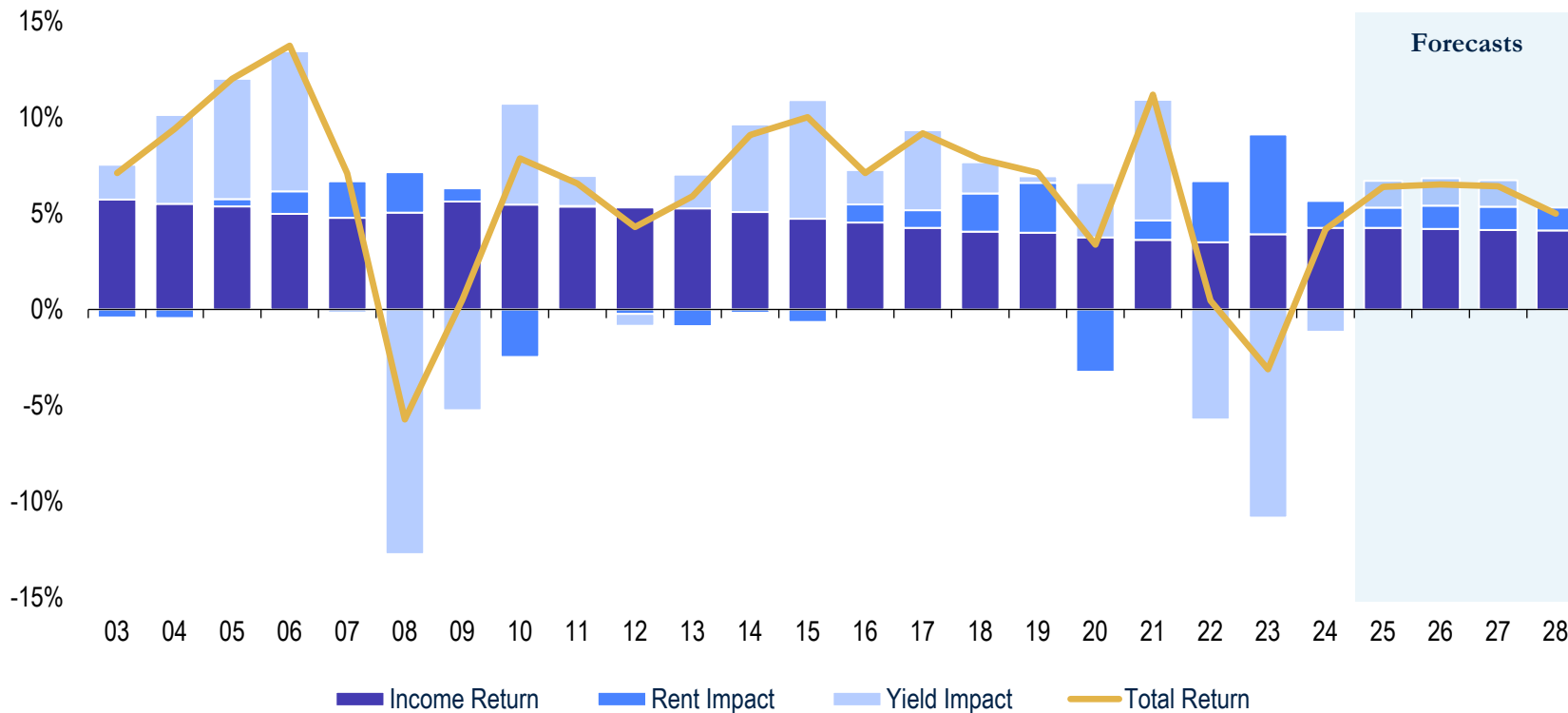
MARKET OUTLOOK

European real estate total returns are back in positive territory and set to improve further in 2025. Assets have repriced and capital values have started to grow on the back of resilient rental growth supported by low supply. Liquidity remains low but is expected to rise significantly in 2025 as downside risks recede and sentiment improves.



Returns Are Back in Positive Territory and Improving

MSCI Europe Annual Property Index, Unlevered All Property Total Returns (% p.a.)



Headline real estate values edged upwards in the second half of 2024 on the back of stable valuation yields and steady occupier market performance.

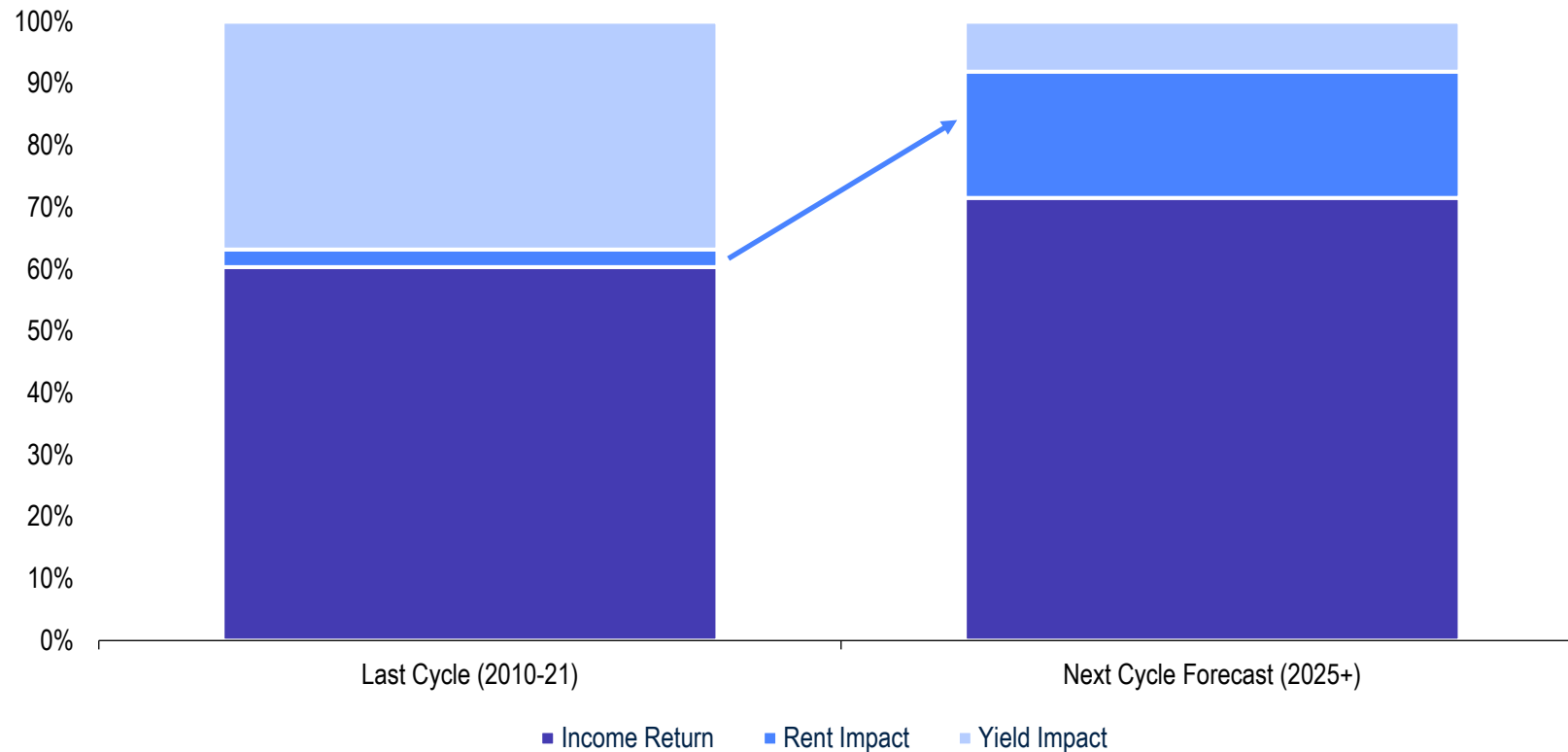
The outlook is for returns to improve further in 2025, supported by lower interest rates and positive income growth.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: MSCI, Cushman & Wakefield, PMA, CBRE, PGIM Real Estate. As of November 2024.

Generating Returns in the Next Cycle? It Is All About Maintaining and Growing Income

Breakdown of MSCI Pan-European Property Index Returns (%)



Yield impact – driven by yields trending lower for much of the last cycle on the back of loose monetary policy – was a significant contributor to total returns up to 2021.

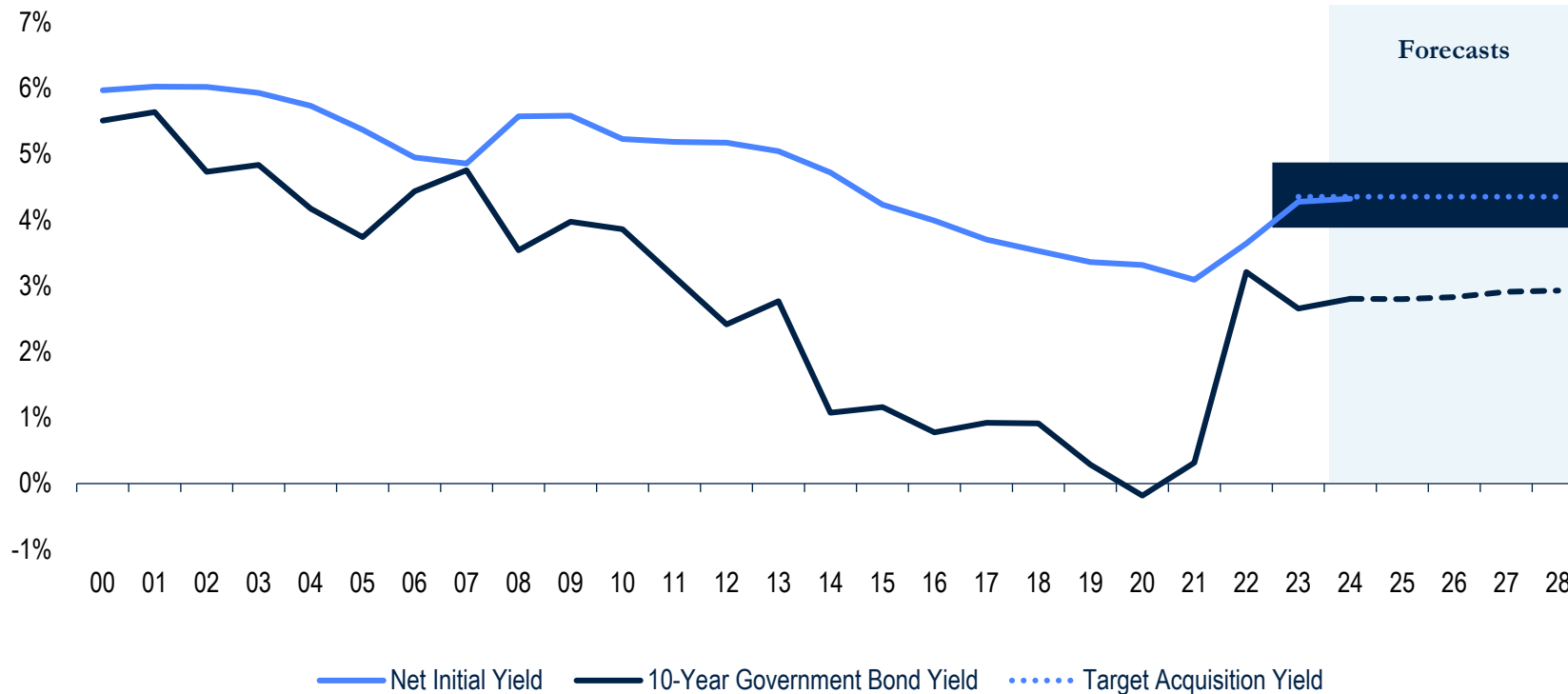
Unlike much of the last cycle, in-place income and income growth is set to be a much more significant component of total returns from 2025 onwards.

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Sources: Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

Where Are We Today? Attractive Income Yields . . .

Europe All Property Prime/Grade A Net Initial Yield (%)



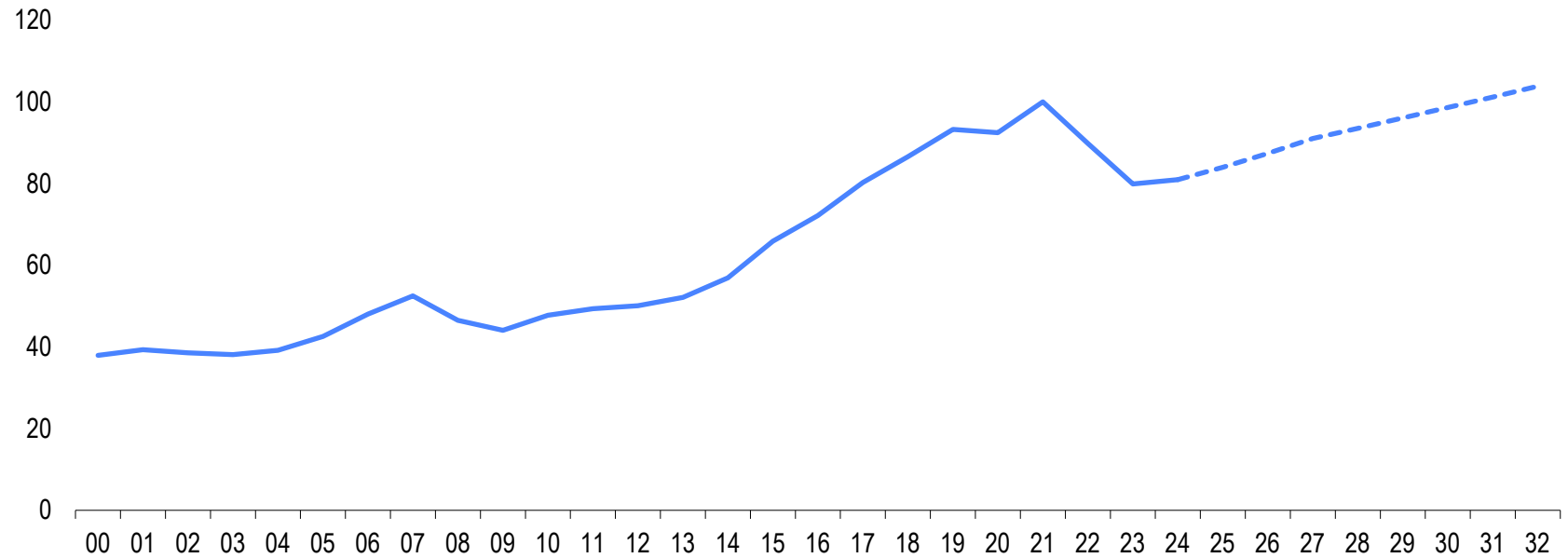
After a significant yield correction over the last two years, market interest rate expectations have stabilized, and real estate pricing is in line with our target.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

... And a Platform for Growth From Low Values

Prime European All Property Capital Values (Index, 2021=100)



European real estate values have stopped falling, and the outlook is for steady growth from today's low levels.

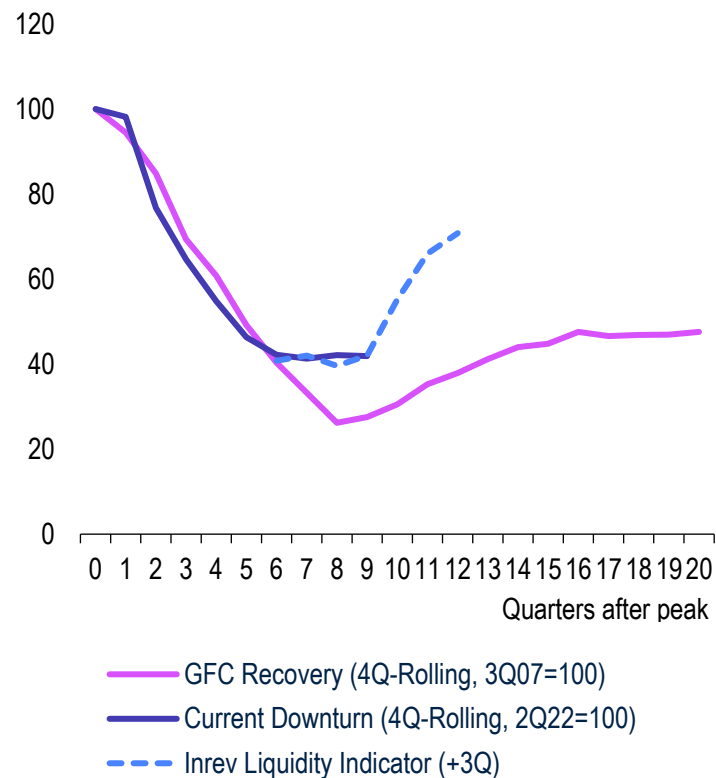
The main driver of capital value growth is rising rents, reflecting expectations of improving economic growth in the coming years.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

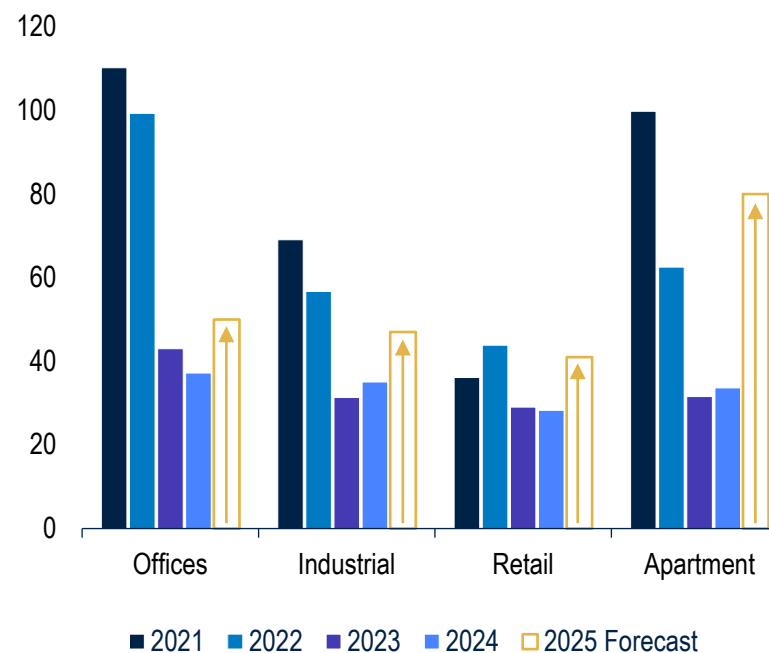
Sources: Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

Liquidity Remains Low, But Investment Activity Is Set to Rebound Going Into 2025

Transaction Volume Recovery (GFC vs. Current Downturn)



European Transaction Volume by Sector (€ Billions)



Transaction activity remained subdued in the first half of 2024. However, volume has stabilized and is set to recover more quickly than after the GFC.

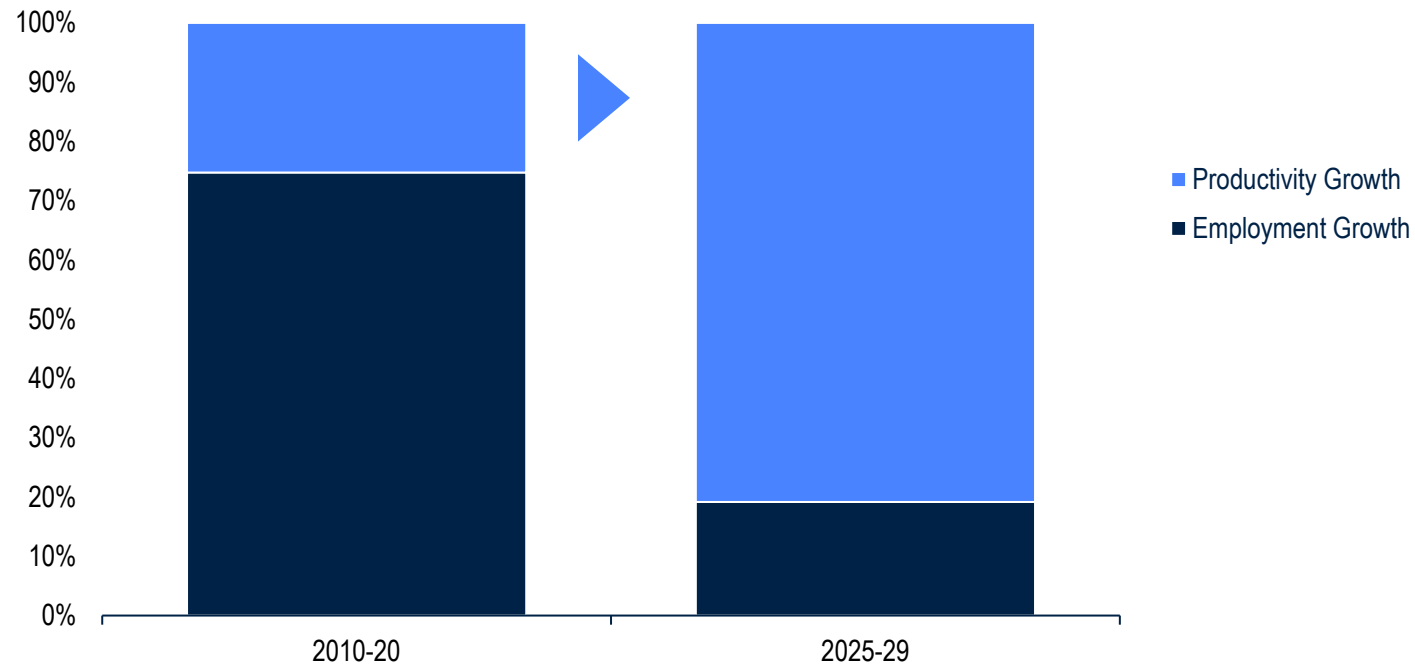
Looking ahead to 2025, our estimates from surveys of investor intentions point to a broad-based pick up across all sectors, but especially in apartments.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: Real Capital Analytics, DTZ, INREV, PGIM Real Estate. As of November 2024.

Productivity Forecasted to Drive Returns

Share of European Cities GDP Growth (%)



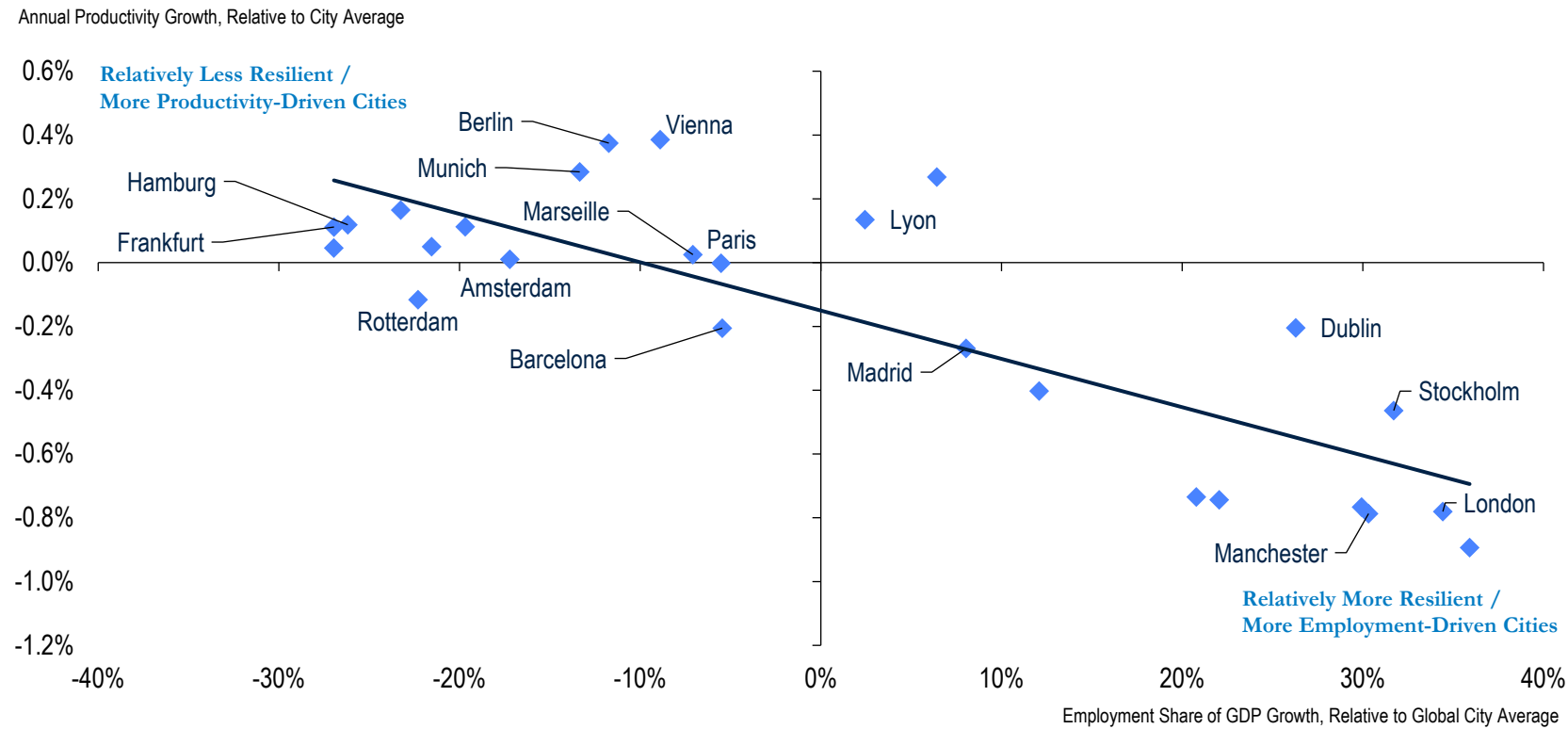
Productivity is set to be a bigger driver of growth in the next cycle as employment growth slows.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: Oxford Economics, Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

City Dynamics Remain Linked to Productivity and Employment Outlook

Relative Productivity Growth vs. Employment Share European Cities (2025-29)



Cities in the UK, the Nordics and Ireland are typically more employment driven and therefore more resilient during downturns.

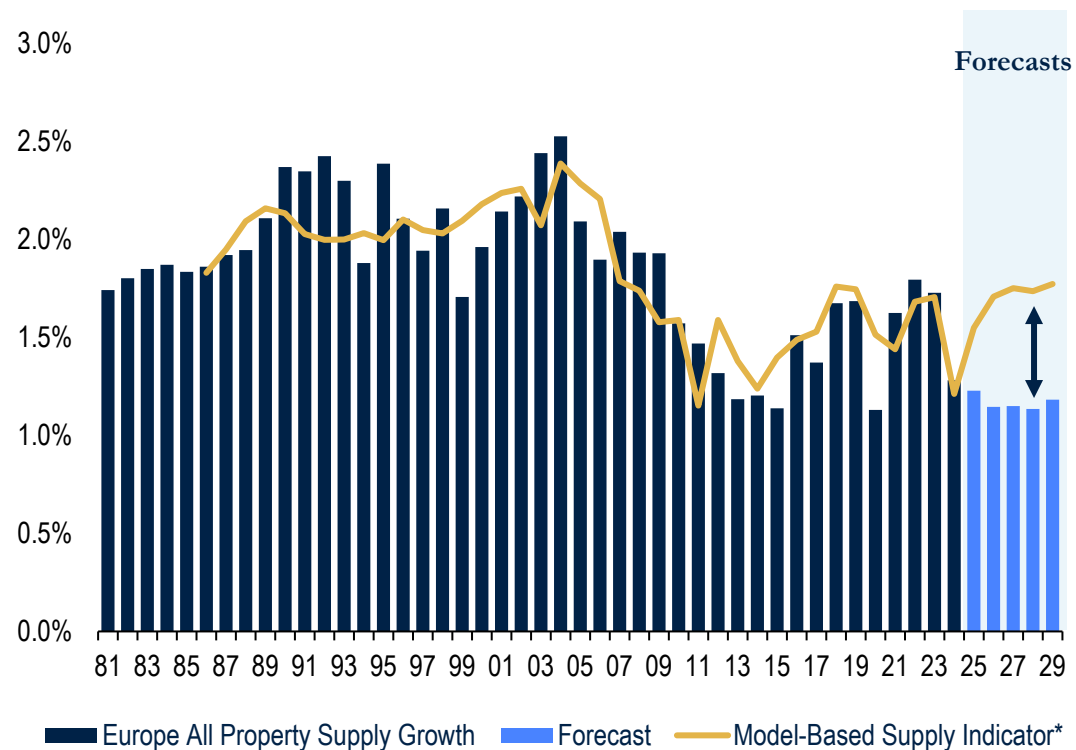
However, cities in Germany, France and the Netherlands bounce back quicker when economic growth, and in particular productivity, picks up.

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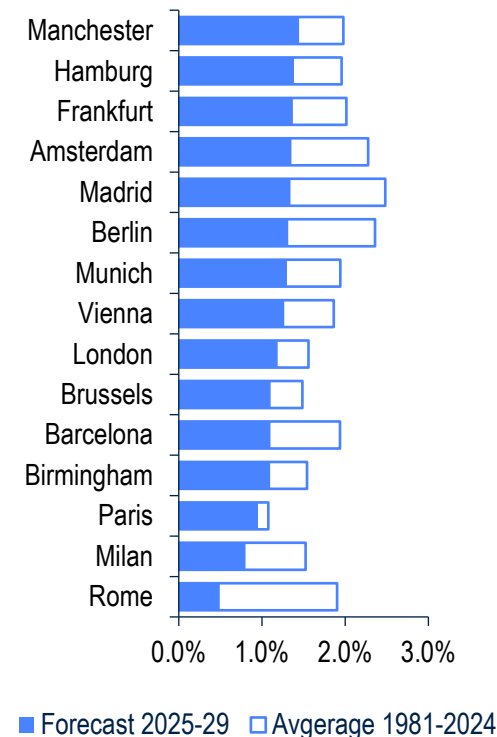
Sources: Oxford Economics, Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

Outlook for Resilient Rental Growth Underpinned by Low Supply Pipeline . . .

Net Additions to European All Property Supply (% p.a.)



Estimated All Property Supply Growth by Major City (% p.a.)



Supply growth was low through much of the last cycle and has dropped on the back of elevated interest rates, high construction costs and lower values.

Supply is set to fall below anticipated requirements based on our model.

Low supply is a consistent theme across European cities. The discrepancies are biggest in previously fast-building Spain, Berlin and Rome.

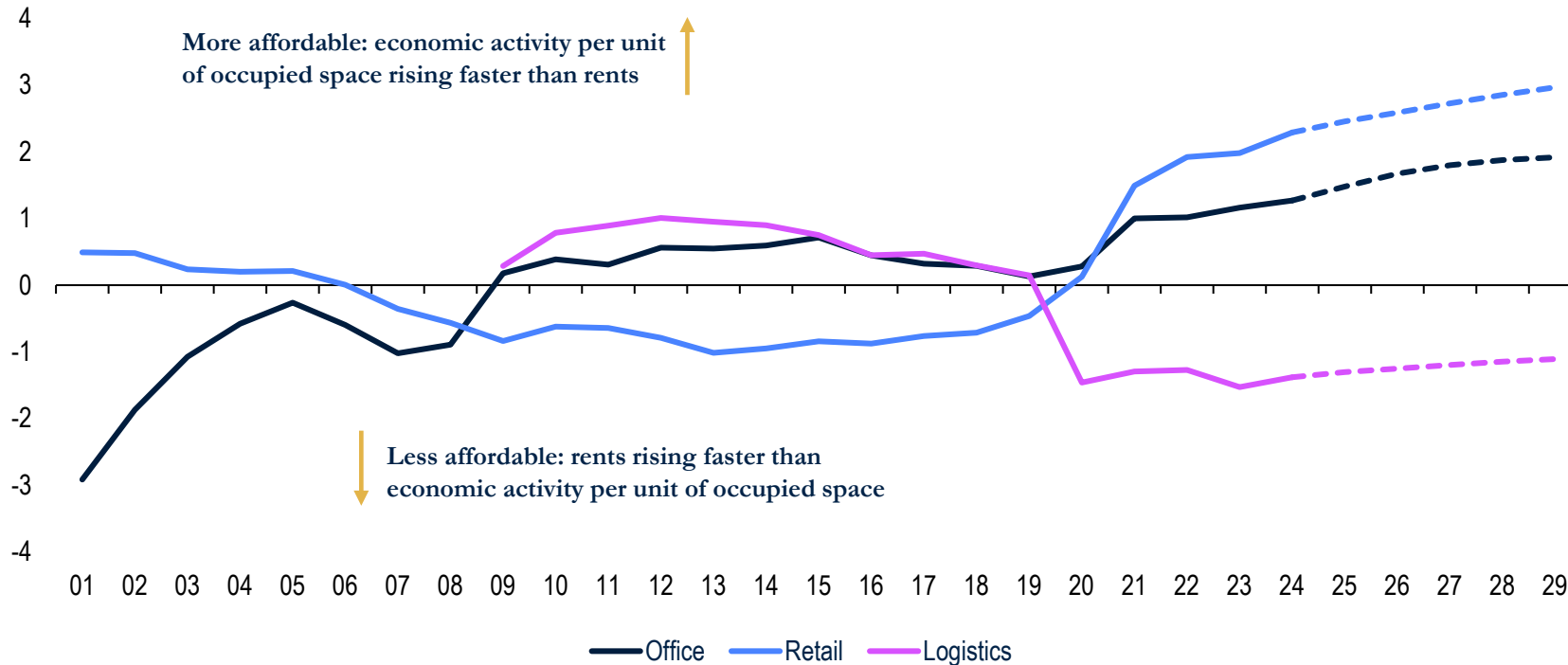
Forecasts are not guaranteed and may not be a reliable indicator of future results.

*Note: Our model-based supply indicator is estimated using a regression that includes real construction costs (3-year lag) and real prime all property rents (2-year lag).

Sources: PMA, PGIM Real Estate. As of November 2024.

... And Supported by Improved Affordability

Commercial Sector Affordability Indices – Europe (Normalized)



Forecasts are not guaranteed and may not be a reliable indicator of future results.

Notes: Affordability is calculated as the ratio of economic output (GVA) per sq m of occupied stock to headline prime rents. Affordability projections assume unchanged total stock and vacancy. Logistics affordability is per sq m of total, rather than occupied, stock.

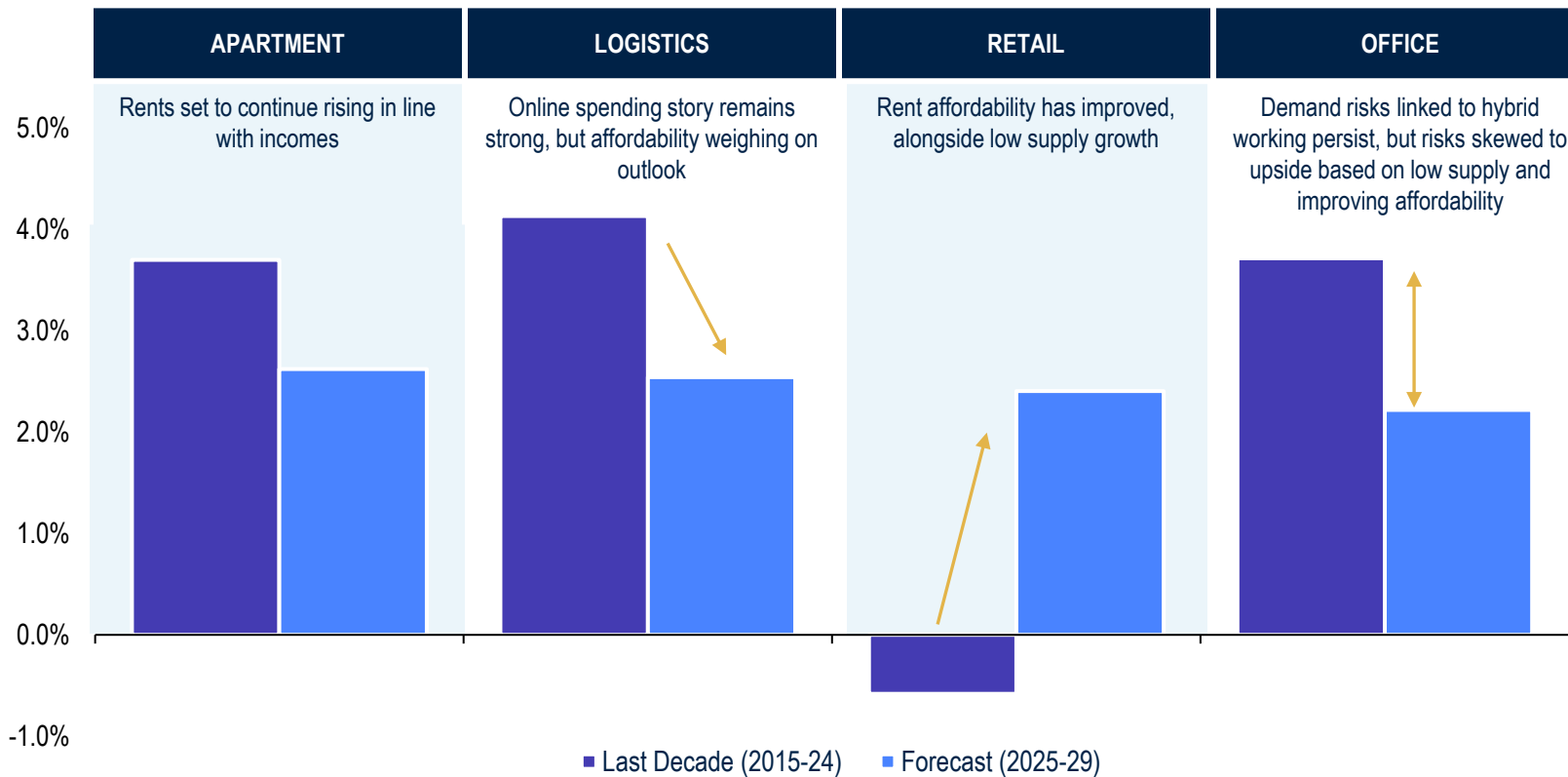
Sources: PMA, Oxford Economics, PGIM Real Estate. As of November 2024.

Space affordability is elevated compared to history in office and retail markets, pointing to upside risks to rental growth forecasts.

However, there are some concerns for logistics, where rapid rent increases in recent years have left affordability looking stretched despite the strength of underlying demand drivers.

Rental Growth Forecasts Are Similar Across Sectors

Prime Rental Growth by Sector – Europe (% p.a.)



An improved retail outlook means forecasts are similar across sectors.

Rents in apartment are expected to rise in line with incomes across Europe, while the logistics story is becoming more selective and aggregate rental growth is driven by markets where e-commerce demand is catching up.

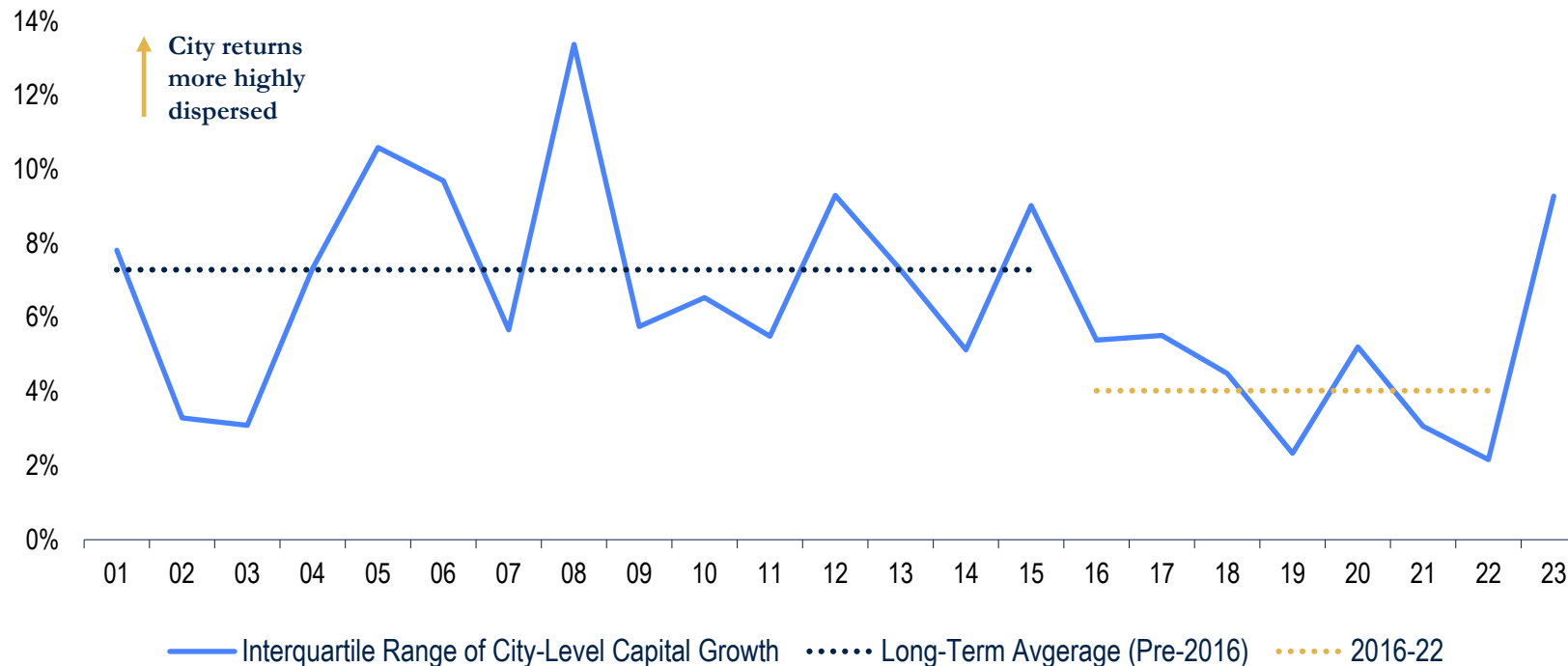
Headwinds in retail and office remain but the rental growth outlook is improving on the back of elevated affordability.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: PMA, PGIM Real Estate. As of November 2024.

So Geographical Diversification Is Becoming More Important Again

Range of Annual City-Level All Property Capital Value Growth (%)



At the same time as performance by sector is becoming more uniform, city value movements have diverged more significantly over the past year.

This speaks to looking more closely at geography over sector in order to identify assets that will outperform.

INVESTMENT OPPORTUNITIES

Investment Strategies

Current market conditions give rise to a wide range of risk and return opportunities.

Structural Themes

Investment conviction driven by basic needs and long-term structural trends that support ongoing demand creation.

Tactical Plays

Opportunities arising from near-term growth, the anticipated cyclical value rebound and market dislocation.



CORE/CORE+ STRATEGIES

Market selection will matter in the next cycle.

VALUE-ADD STRATEGIES

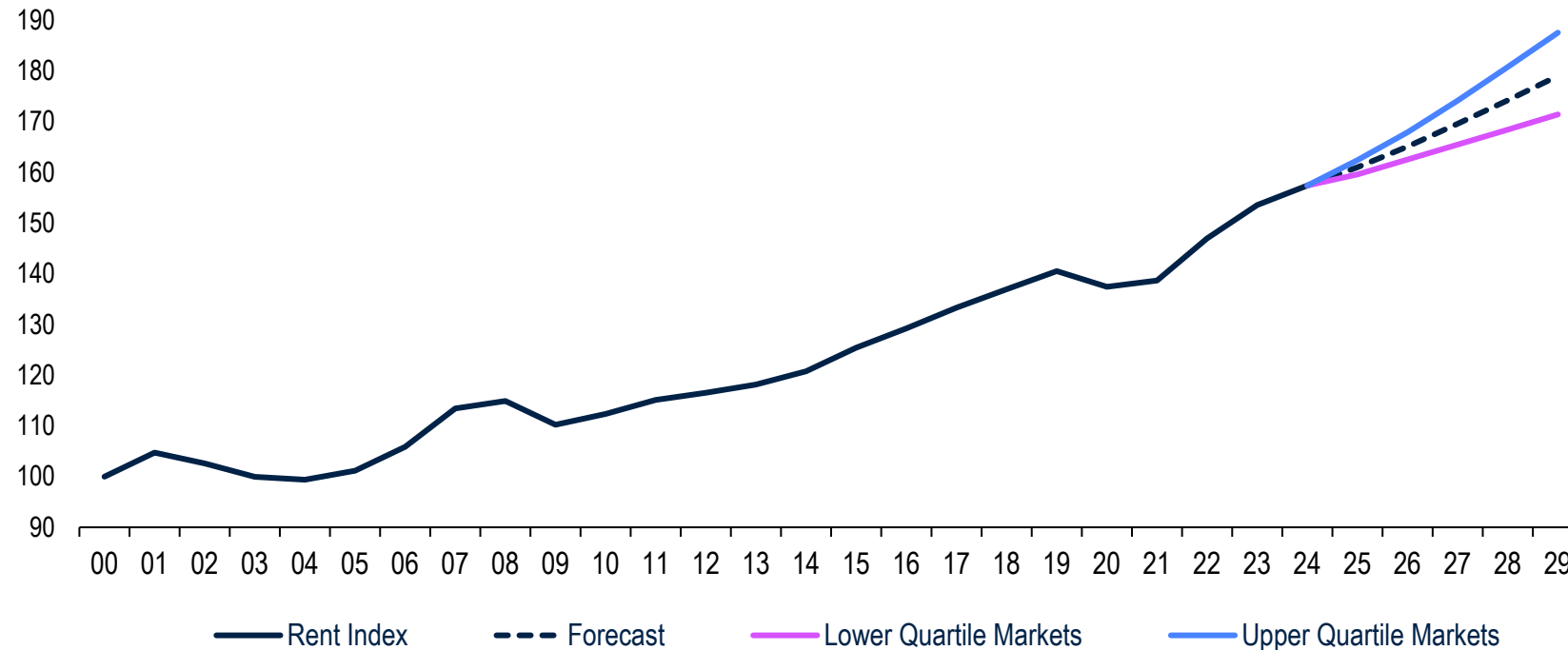
The need for capital injections into existing stock.

CREDIT STRATEGIES

Increased share of non-bank lending will continue in 2025.

Core/Core+ Strategies: The Importance of Market Selection

Index of Prime European All Property Headline Rents (1Q01=100)



Selecting the right cities and submarkets can lead to outperformance. Upper quartile markets include core European apartment and logistics markets and tourist-driven city retail markets.

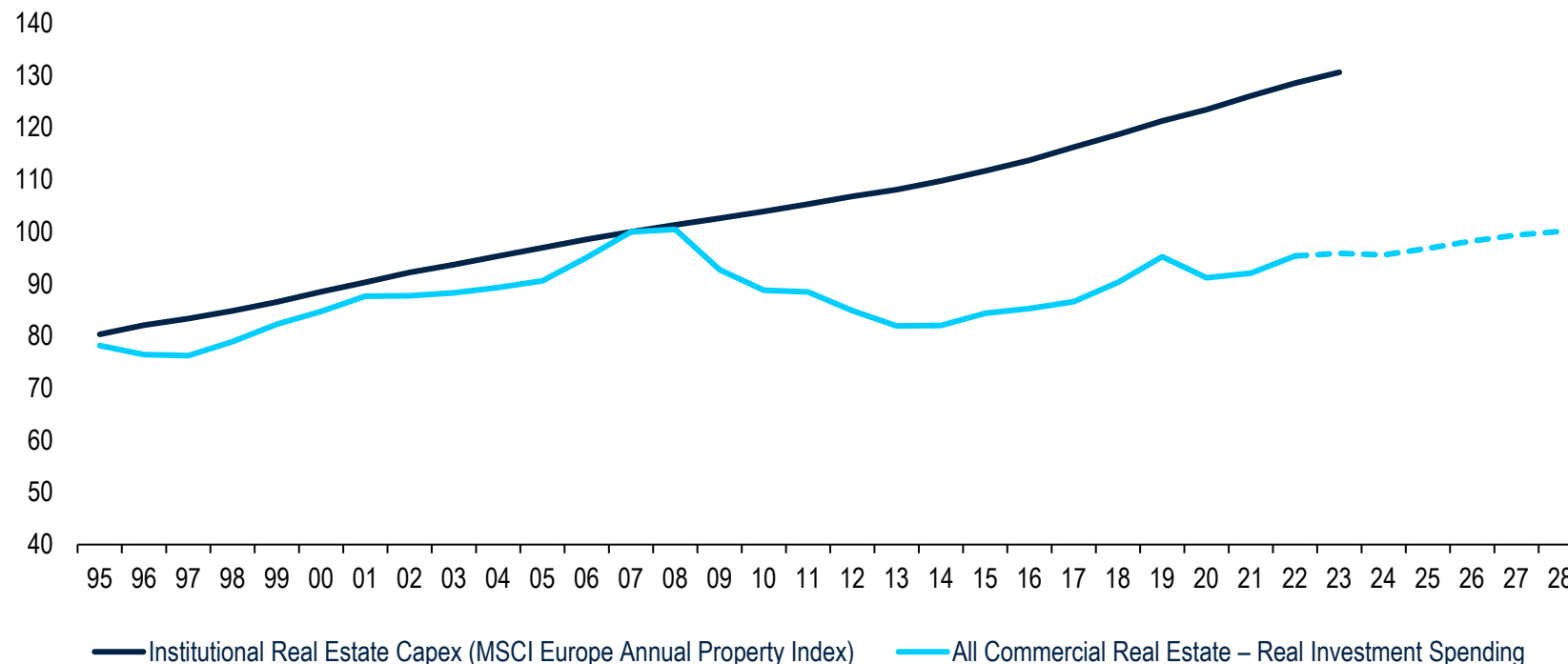
Office markets and non-tourist retail markets comprise most of the lower quartile.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Sources: PMA, Cushman & Wakefield, CBRE, PGIM Real Estate. As of November 2024.

Value Add Strategies: The Need for Capital Spending

Index of European Capex Spending (2007 = 100)



Institutional investment capex held up better but many buildings across Europe will need fresh capital injections, especially as ESG requirements are growing too.

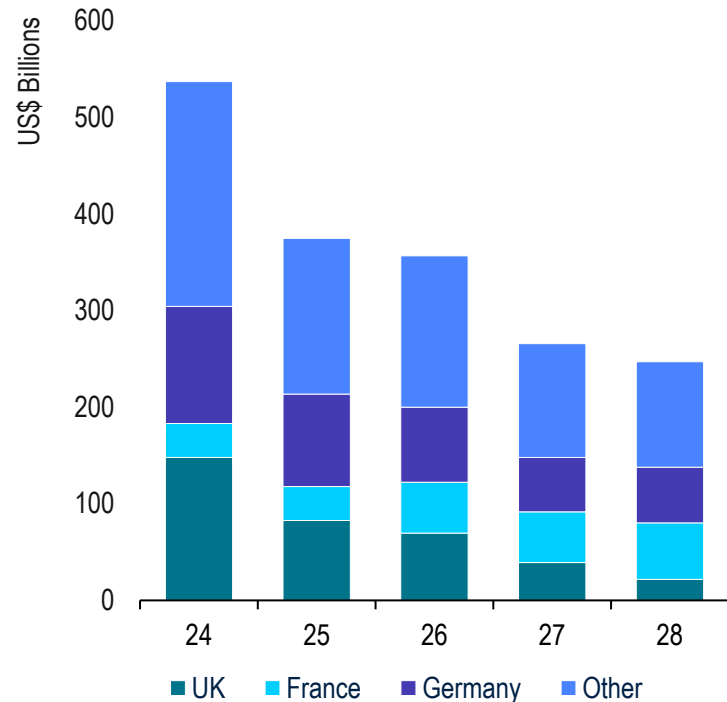
In the wider economy, the last cycle was characterized by a relatively low pace of investment going into the built environment.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

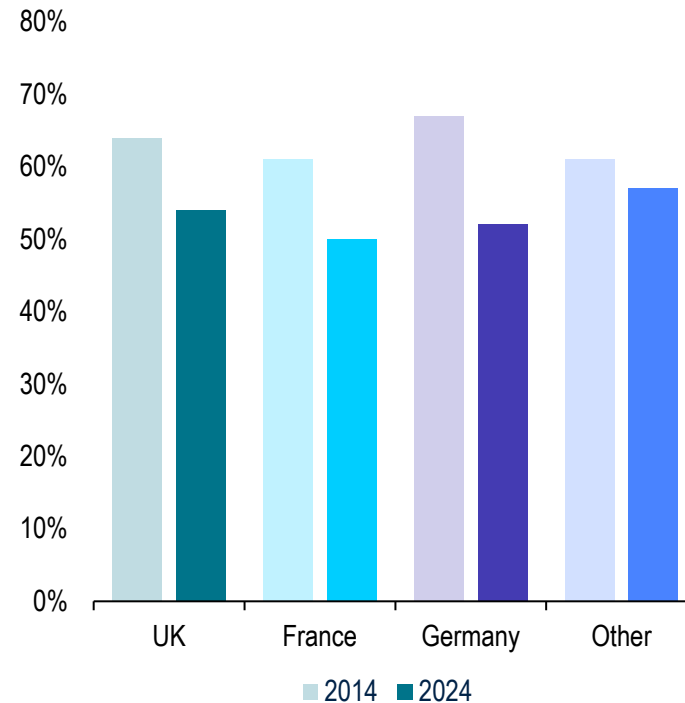
Sources: OECD, Oxford Economics, MSCI, PGIM Real Estate. As of November 2024.

Credit Strategies: Non-Bank Lenders to Capitalize on Refinancing Gap

European Loan Maturities



New Loan LTVs



The spike in year one loan maturities is particularly pronounced in this cycle due to a backlog of refinances from earlier years.

New loans face tighter LTVs due to debt service constraints and stricter lending criteria.

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Sources: Bayes Business School, IEIF, IREBS, ECB, PMA, Finloop, PGIM Real Estate. As of November 2024.

Summary of European Investment Opportunities

	NATURE OF OPPORTUNITY	REAL ESTATE APPROACH
 LIVING SECTOR	<p>Demographics High construction costs Low homeownership affordability</p>	<ul style="list-style-type: none"> • For-rent apartments • Micro-living • Purpose-built student accommodation • Senior housing
 LOGISTICS	<p>E-commerce growth Urban infill supply constraints</p>	<ul style="list-style-type: none"> • Infill logistics • Big box / supply chain
 DATA CENTERS	<p>Data demand outstripping capacity Need for new development</p>	<ul style="list-style-type: none"> • Hyperscale • Colocation
 CREDIT	<p>Refinancing gap Bank retrenchment Lower attachment points</p>	<ul style="list-style-type: none"> • Core originations • Transitional debt • Subordinated debt
 TACTICAL	<p>In-store consumer spending Tourism demand recovery Office space affordability</p>	<ul style="list-style-type: none"> • High street retail • Hotels • CBD office



1. LIVING SECTOR

Needs-based real estate that meets affordability objectives, targeting growing demographic segments in preferred locations.



2. LOGISTICS

Consumer, manufacturing and logistics-driven properties; selective on size and focused on shifting global trade patterns.



3. DATA CENTERS

Ongoing favorable demand-supply dynamics due to essential digital infrastructure needs.



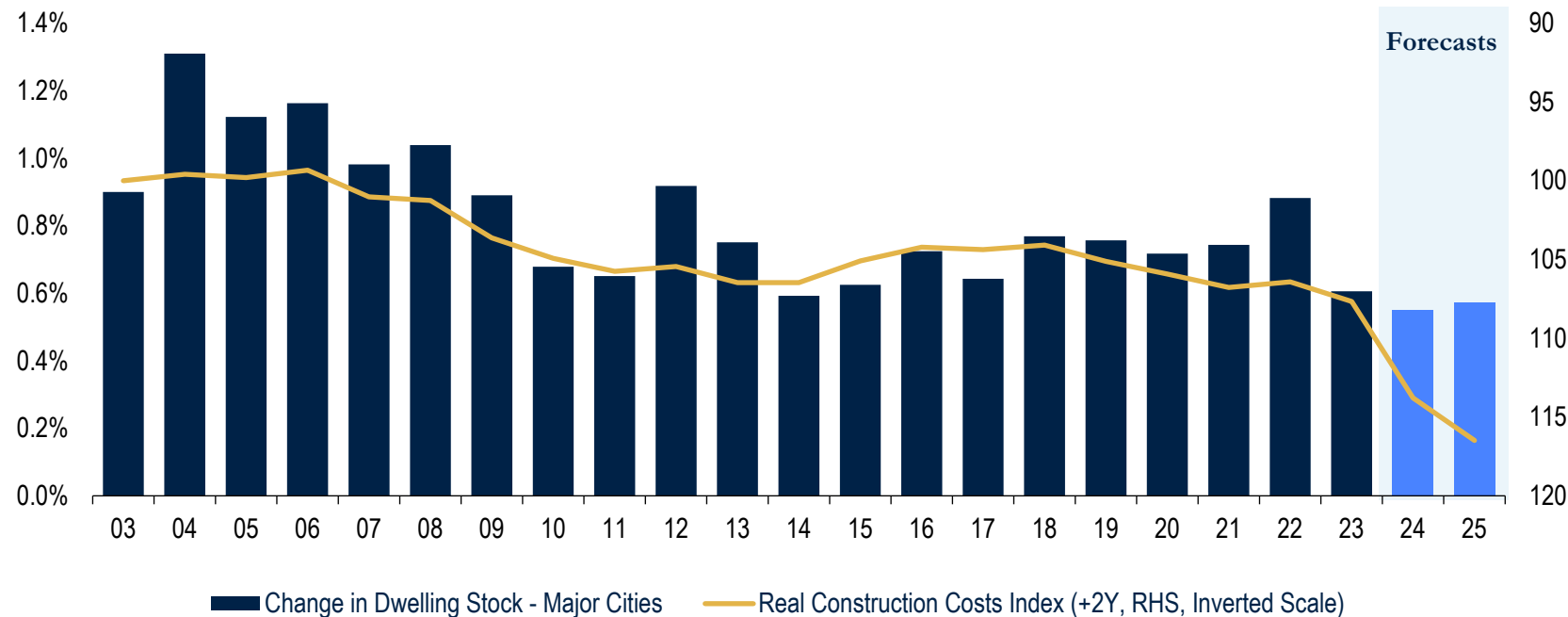
4. CREDIT

Capturing opportunities to lend as transaction volumes improve.



Residential: Elevated Construction Costs Are Weighing on Supply...

Change in European Dwelling Stock (% of Stock) and Real Construction Costs (Index)



Supply growth has fallen back significantly on the back of a sharp increase in real terms building costs. This is set to continue for several years.

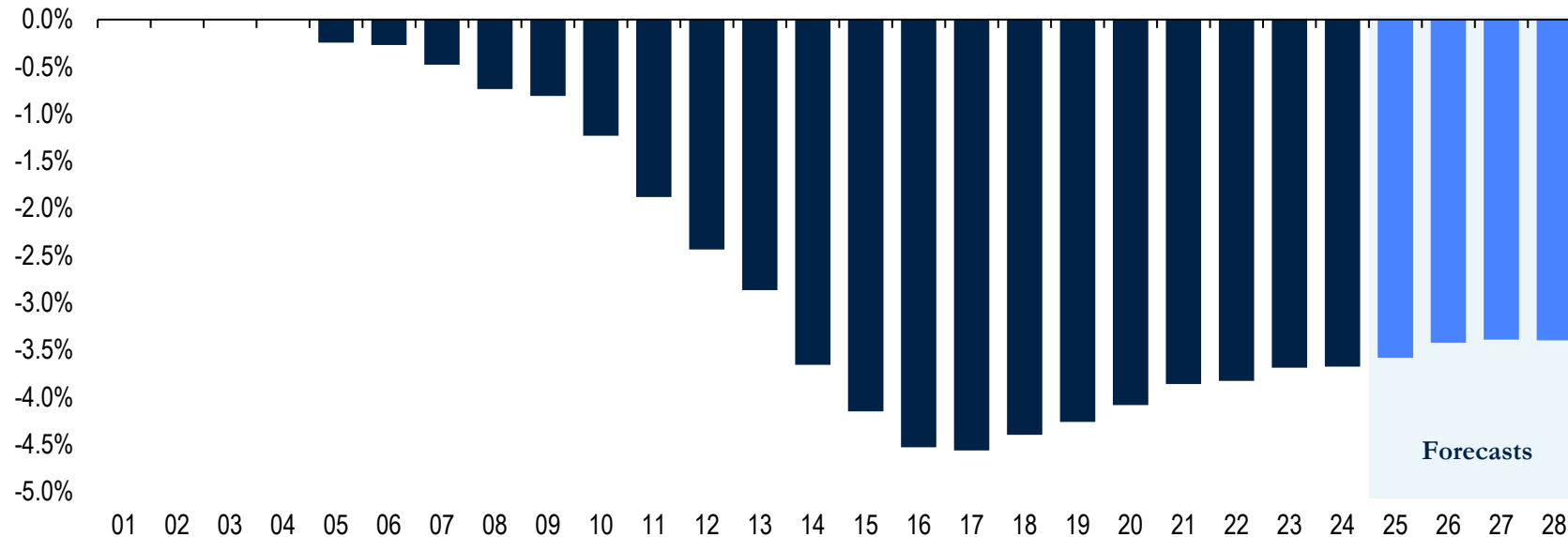
Forecasts are not guaranteed and may not be a reliable indicator of future results.

Note: Major European Housing Markets' comprises Copenhagen, Paris, Berlin, Frankfurt, Hamburg, Munich, Milan, Amsterdam, Madrid, Stockholm, London, Birmingham and Manchester. Unmet requirements are implied in years in which the growth in the number of households exceeds the change in the dwelling stock. Sources: PMA, Oxford Economics, PGIM Real Estate. As of November 2024.



Residential: . . . And a Significant Housing Shortfall Has Emerged

Estimated European Housing Shortfall, Major Cities (% Total Households)



A significant shortfall of housing has opened up in recent years across European markets, which is supporting the rental growth outlook, despite affordability being stretched by rising rent-to-income ratios in many cities.

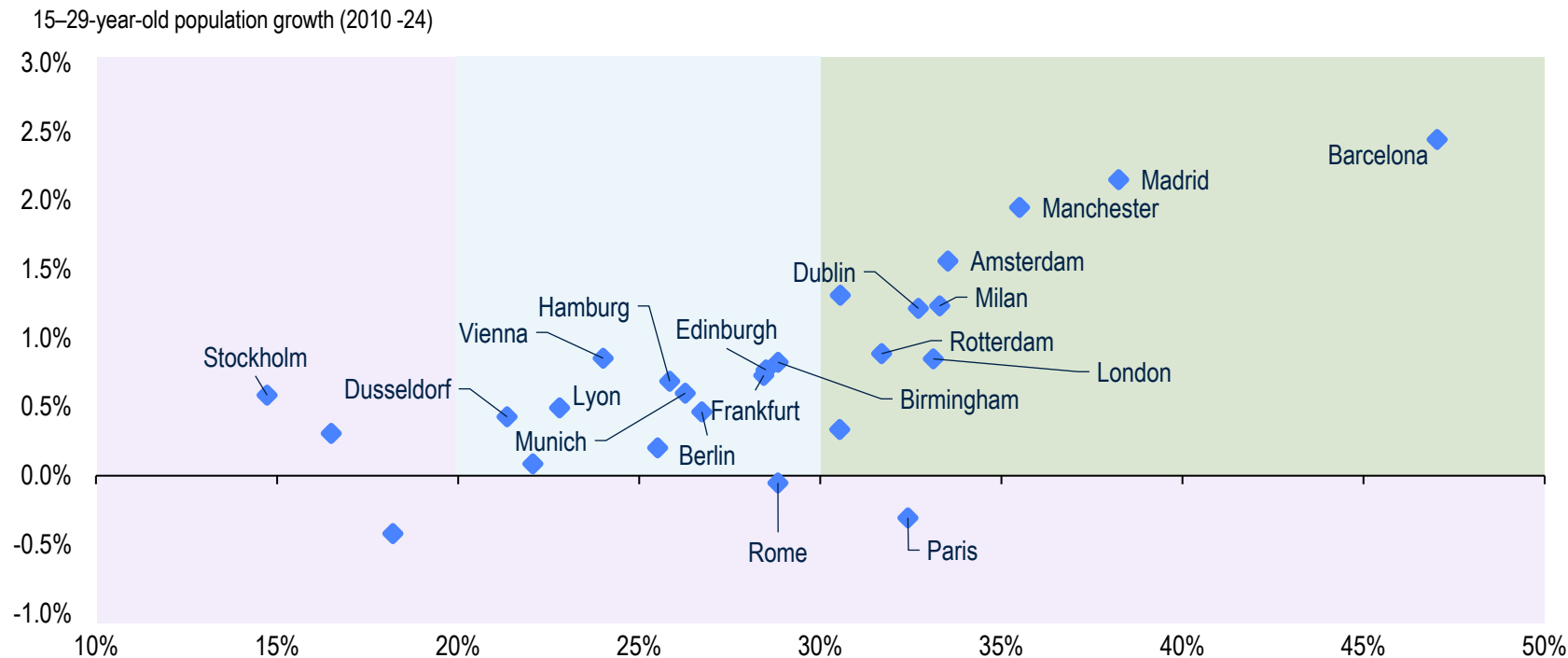
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Co-Living/Student Housing: Affordability Pressures and Young Population Growth Supporting Outlook

Rent to Household Income Ratio vs. Young Population Growth



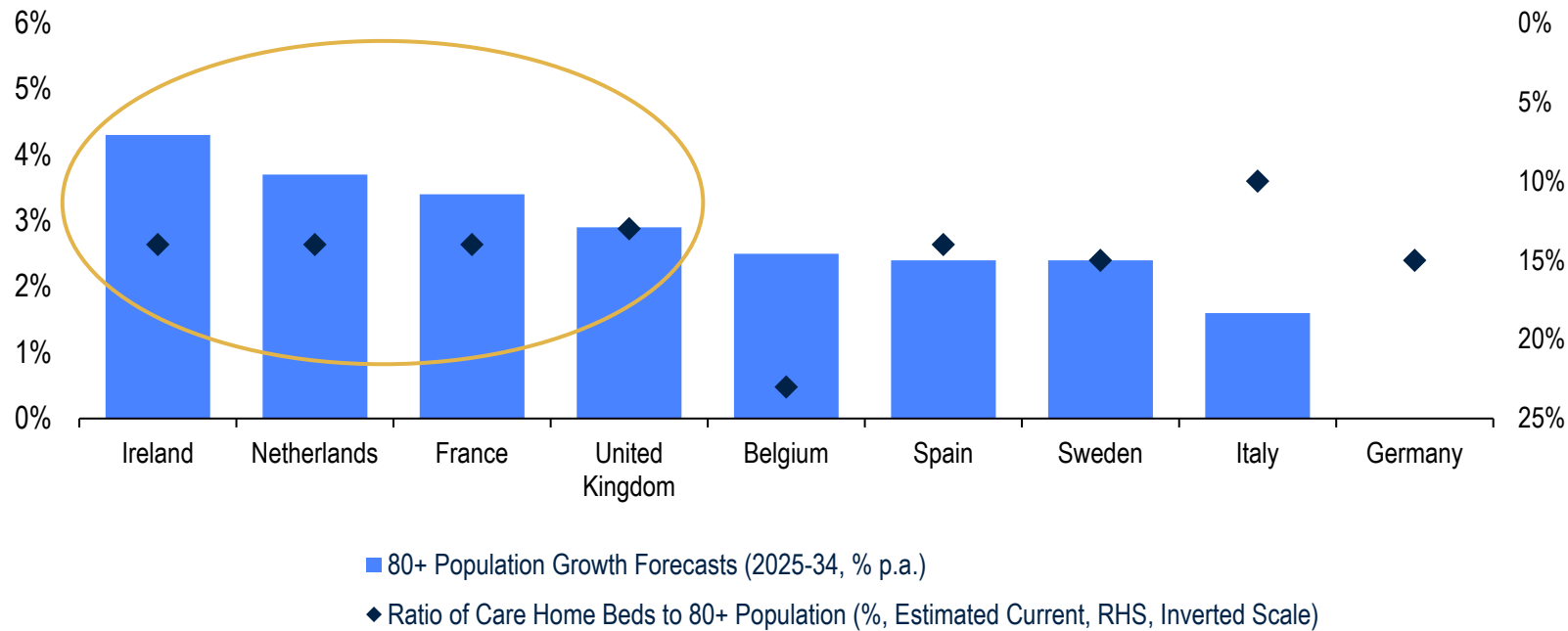
Stretched affordability paired with young population growth is driving opportunities in co-living as well as purpose-built student accommodation as renters compromise on size over quality.

The opportunity set is largest in the UK, Spain and the Netherlands, but there are also pinch points in other markets with high population density such as Frankfurt or Munich.



Senior Housing: Outlook Is Driven by Favorable Demographics and Limited Bed Provision

Europe 80+ Population Forecasts (% p.a.) vs. Care Home Bed Provision (% , Estimated)



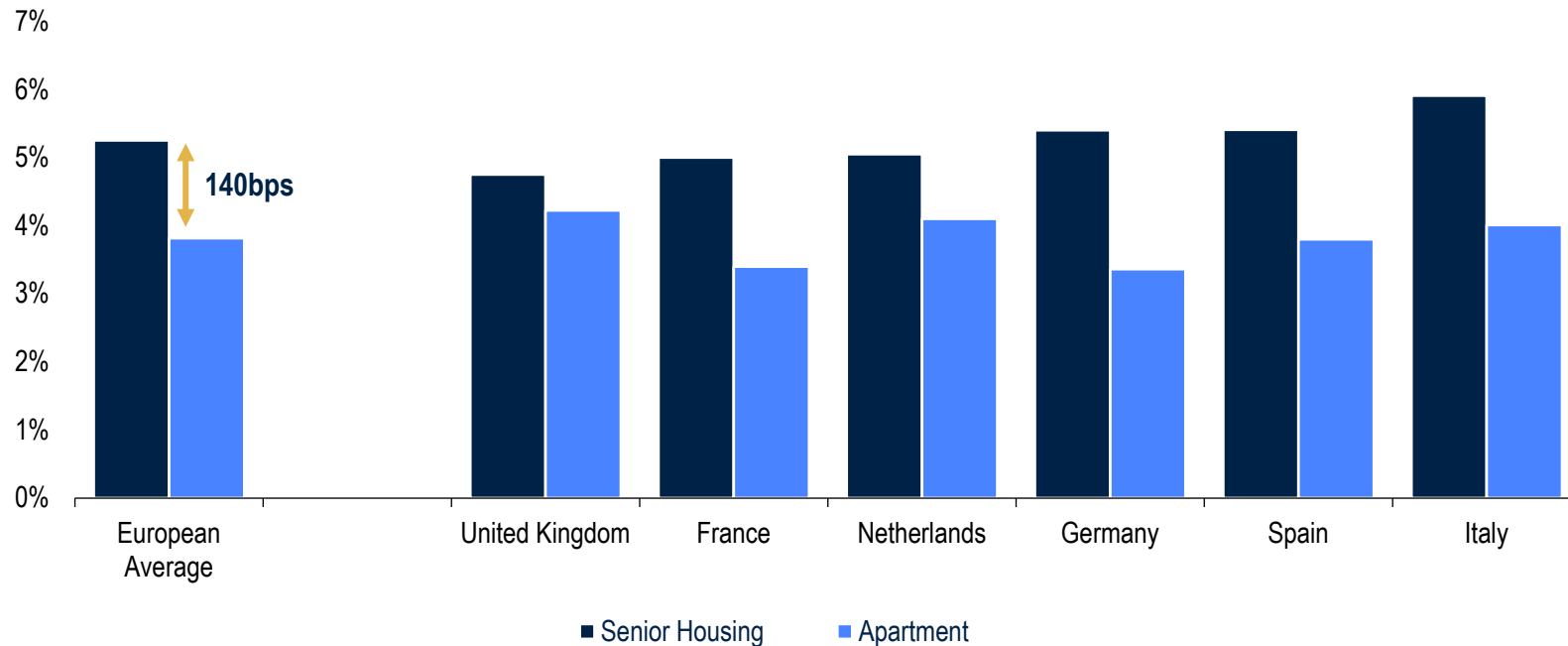
Senior housing opportunities have the most potential in the UK, Ireland, France and the Netherlands due to favorable 80+ population forecasts and low care home bed provisions.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.



Senior Housing: Attractive Returns From Operational Structure

Prime Yields: Senior Housing vs. Apartments 3Q24 (% , Estimated, Select Markets)



Positive spreads between senior housing and apartment prime yields provide enhanced income returns for investors that are geared up to take on operational risk and execute on intensive asset management strategies.

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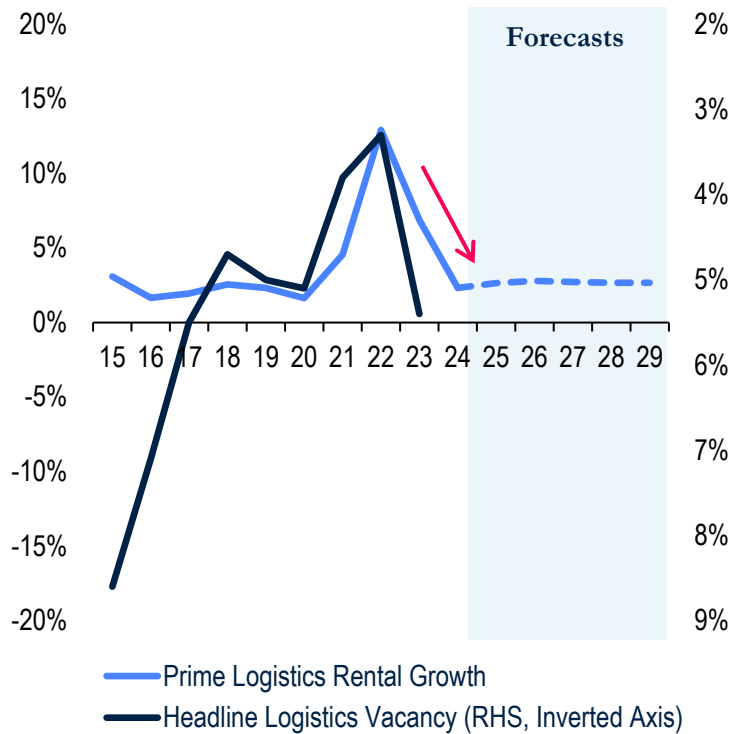
Note: Apartment yields here are the national averages covering the major markets of London, Manchester, Paris, Amsterdam, Berlin, Frankfurt, Hamburg, Munich, Madrid and Milan.

Sources: Cushman & Wakefield, PMA, PGIM Real Estate. As of November 2024.

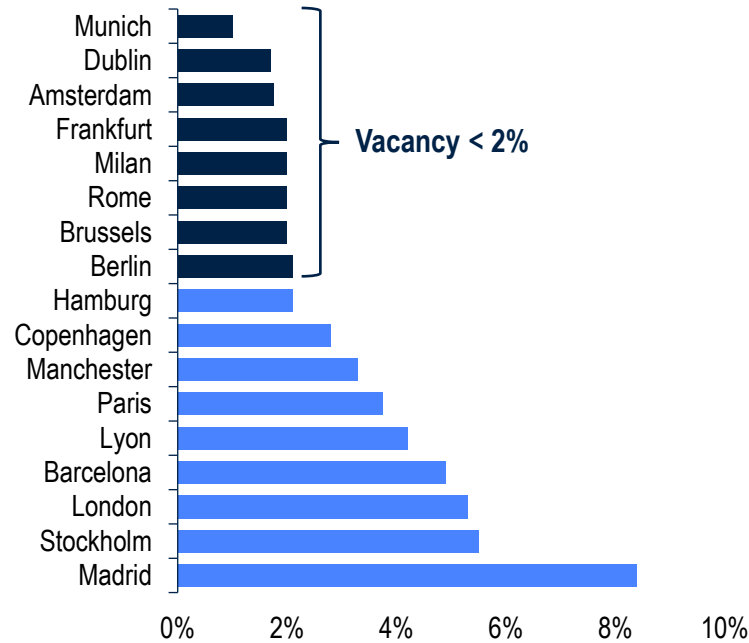


Logistics: Vacancy Rising, but Available Supply Remains Limited in Some Cities

European Logistics Vacancy vs. Rental Growth



Estimated Logistics Vacancy by Major City



Headline logistics vacancy is rising toward pre-pandemic levels.

Rental growth is becoming more selective, but the outlook is most resilient where vacancy is low.

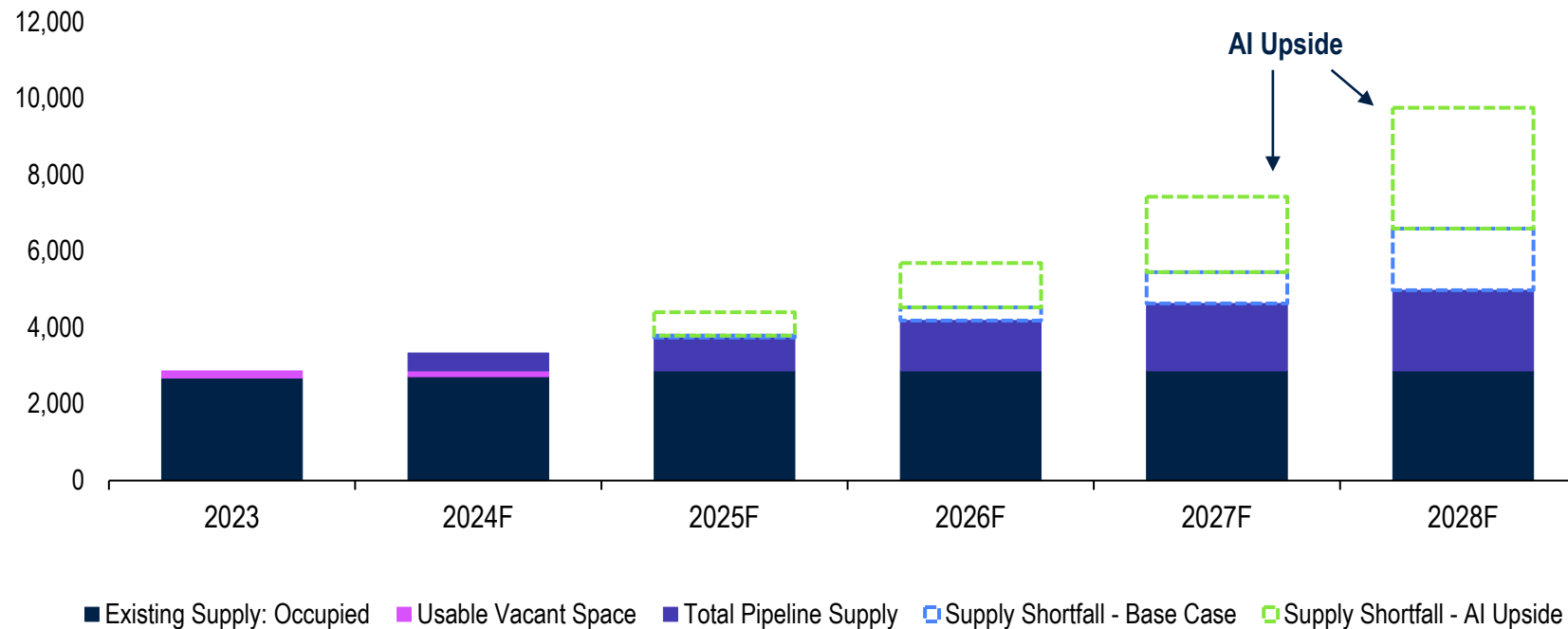
In markets where vacancy is elevated, the focus is on identifying assets in strategic locations or in resilient submarkets to deliver growth.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: Colliers, PMA, Oxford Economics, PGIM Real Estate. As of November 2024.



Data Centers: Demand Set to Significantly Outstrip Supply in Europe

Estimated Data Center Supply Shortfall (MW, FLAPD)



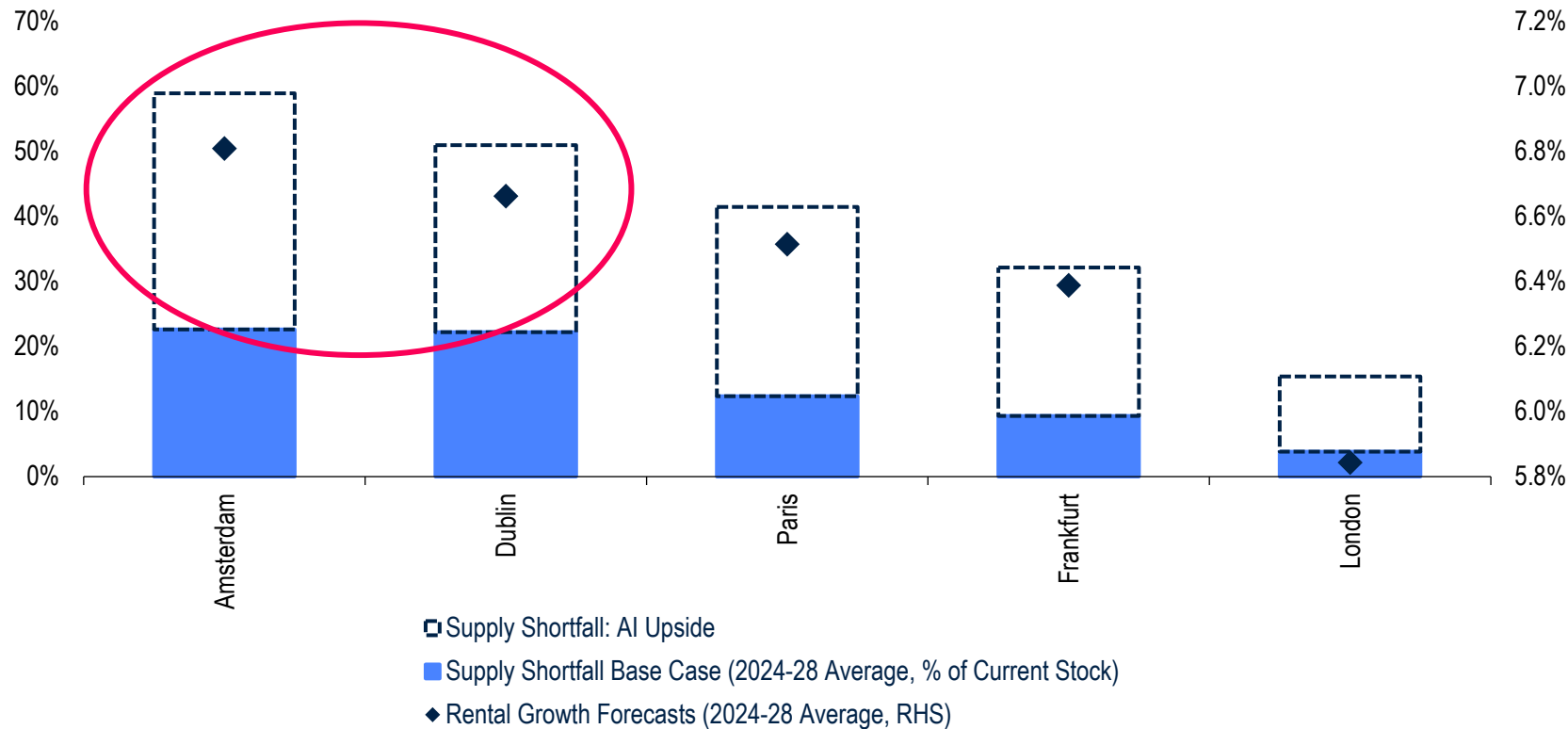
Despite rising efficiencies, demand for data center capacity is rising, creating a supply shortfall, particularly if AI adoption rises in line with expectations.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: JLL, Green Street, Arthur D Little, PGIM Real Estate. As of November 2024.



Data Centers: The Supply Shortfall Points to Strong Rental Growth

Data Center Shortfall vs. Rental Growth Forecasts (% p.a.)



Among the major FLAP-D markets, Amsterdam and Dublin are forecasted to have the largest supply shortfall by 2028 and therefore have the strongest rental growth projections.

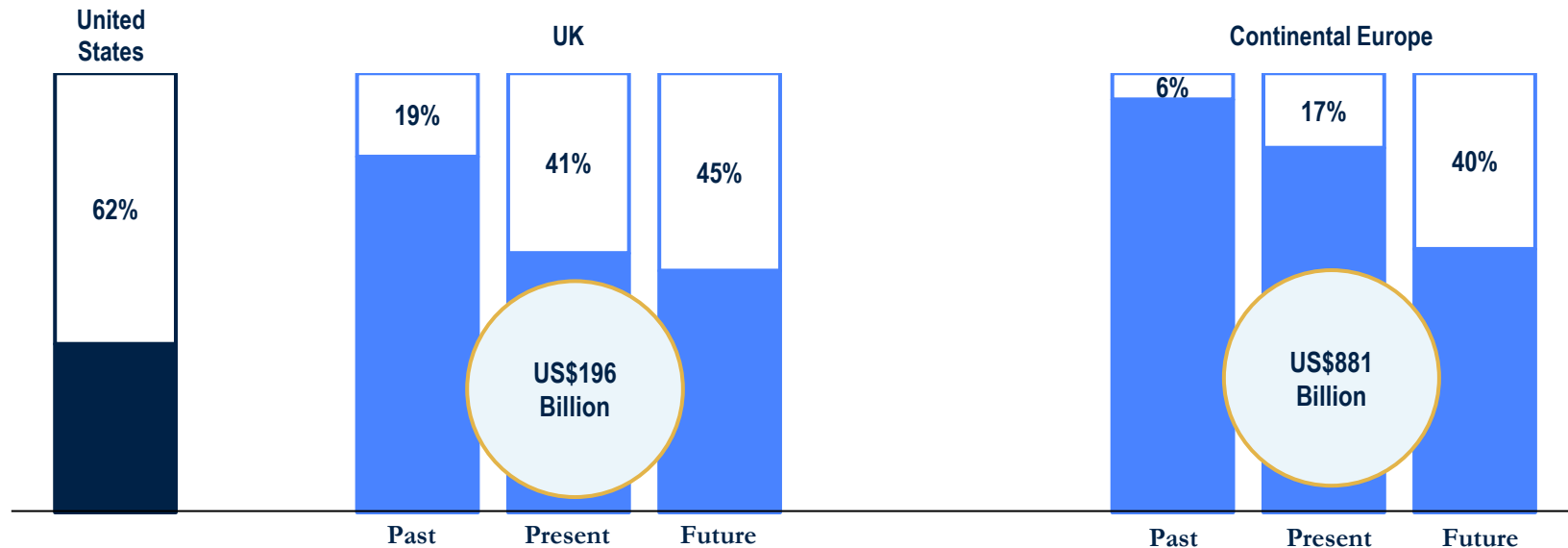
Potential AI upside is also significant in Paris and Frankfurt.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: JLL, Green Street, Arthur D Little, PGIM Real Estate. As of November 2024.



Non-Bank Lenders to Further Increase Market Share to Capitalize on Refinancing Gap

Market Composition: Bank vs. Non-Bank Market Share



There is a significant opportunity in Europe for alternative lenders to gain more market share from traditional banks as the latter are more heavily regulated.

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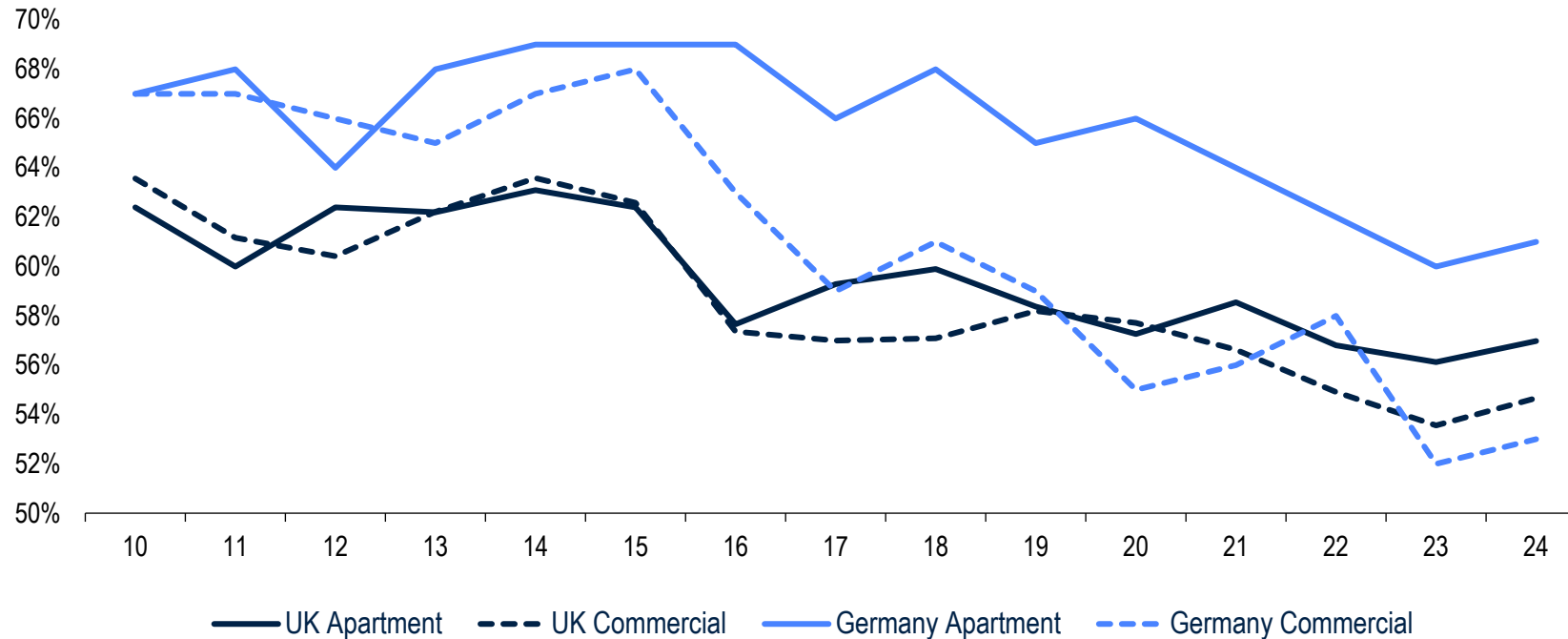
Note: Past refers to 2014, present to 2024 and future to market potential based on the UK and U.S. market compositions. The U.S. non-bank lender market includes GSEs (government-sponsored enterprises), which are not prevalent in any other market and comprise 21.8% of the U.S. market.

Sources: Cushman & Wakefield, Mortgage Bankers Association, Bayes Business School, ECB, IEIF, IREBS, APRA, MSCI/RCA, PGIM Real Estate. As of November 2024.



Lenders to Benefit From Rising Values

New Loans LTV (UK and Germany)



Lenders are also benefiting from lower attachment points at a time when values start to grow, which should provide additional future security at current attractive debt pricing.

Sources: Cushman & Wakefield, Mortgage Bankers Association, Bayes Business School, ECB, IEIF, IREBS, APRA, MSCI/RCA, PGIM Real Estate. As of November 2024.



1. RETAIL

Opportunities emerging on the back of elevated affordability as well as more in-store spending.



2. HOTEL

A strong demand backdrop is benefiting tourism markets.



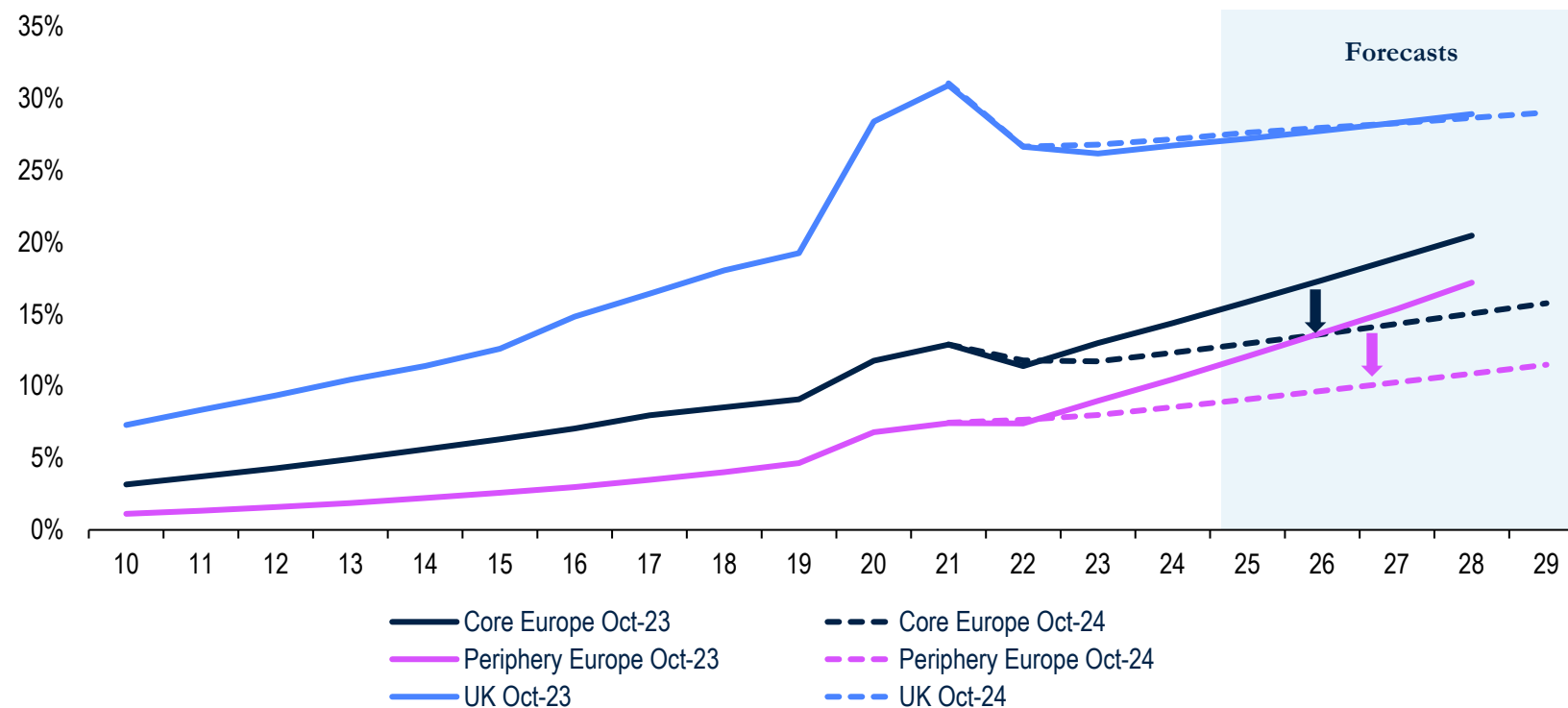
3. OFFICE

Selective investment opportunities in CBD markets where productivity has outgrown rents, pointing to income catch-up potential.



Retail: E-Commerce Adoption Revised Down...

Online Share of Retail Spending (%)



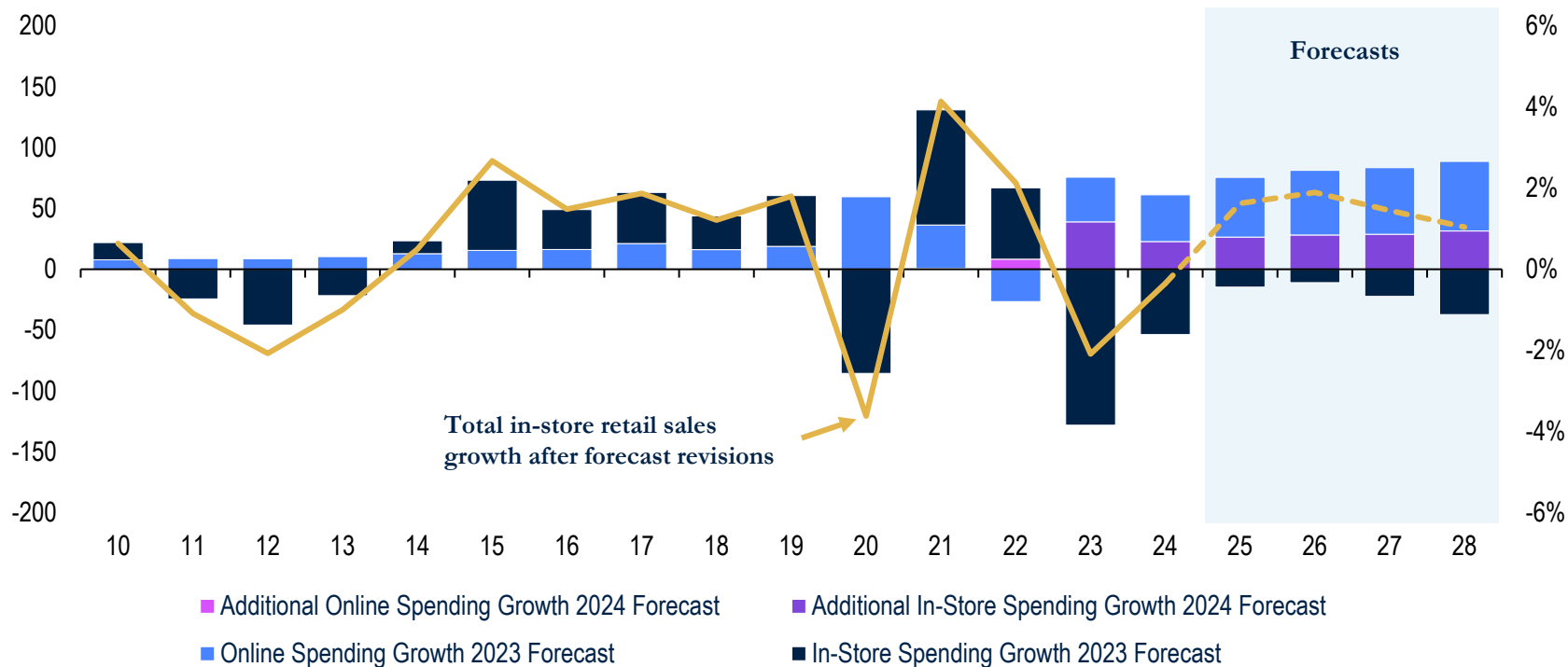
E-commerce penetration rates in Continental Europe have been revised down significantly over the last year as consumers switched back to in-store retail more significantly than previously anticipated.

Forecasts are not guaranteed and may not be a reliable indicator of future results. Sources: PMA, Oxford Economics, PGIM Real Estate. As of November 2024.



Retail: . . . Resulting in Rising In-Store Spending

Retail Spending Growth - Continental Europe (Real, 2024 Prices, € Billions)



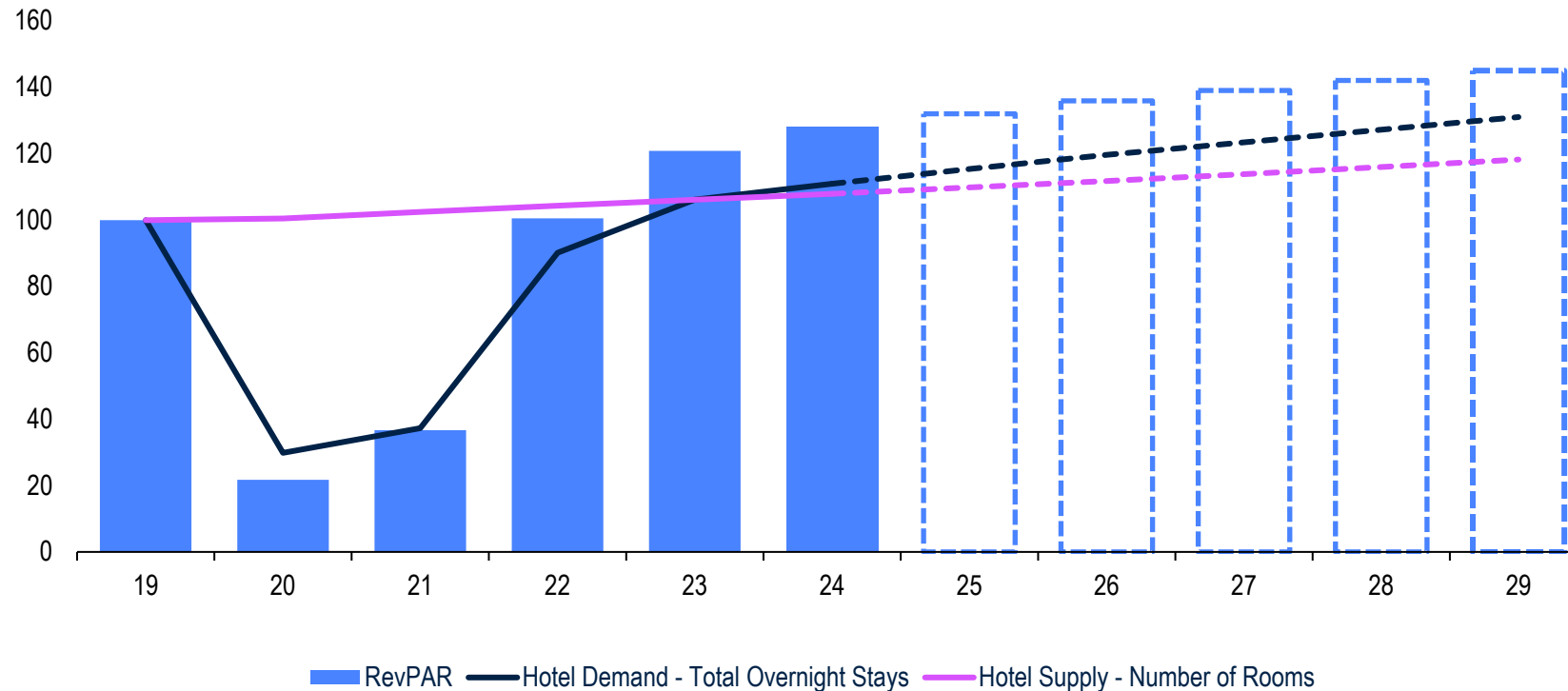
In-store spending is now turning positive from 2025 onwards, while under previous forecasts in-store spending was still falling in net terms over the next few years.

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Sources: PMA, Oxford Economics, PGIM Real Estate. As of November 2024.



Hotel: Strong Demand Recovery

European Hotel Demand, Supply and RevPAR Index Performance (2019=100)



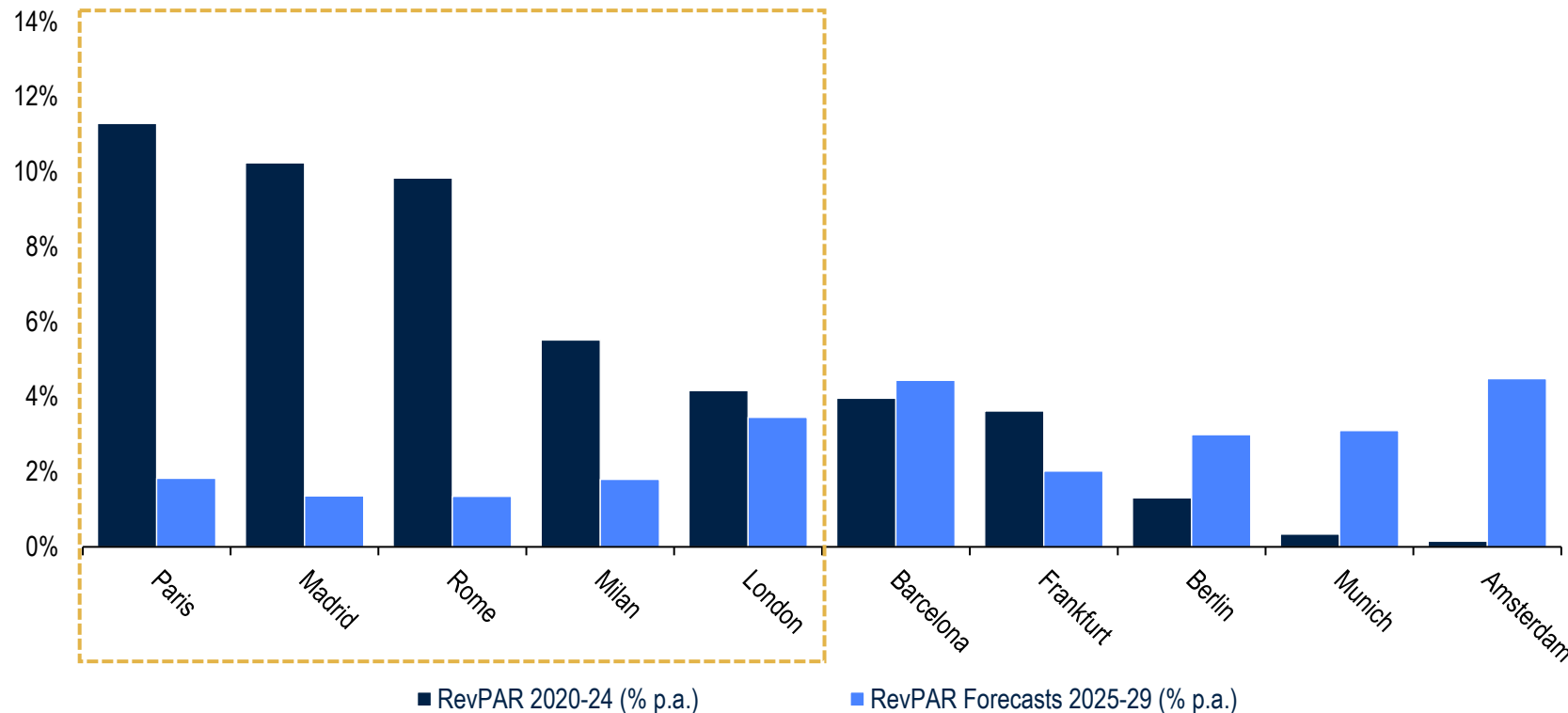
A strong recovery in travel demand and subdued supply is feeding through into expectations for ongoing growth in revenue per available room (RevPAR) across all of Europe.

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Sources: PMA, PGIM Real Estate. As of November 2024.



Hotel: Attractive Income Growth

Hotel RevPAR Performance by City (% p.a.)



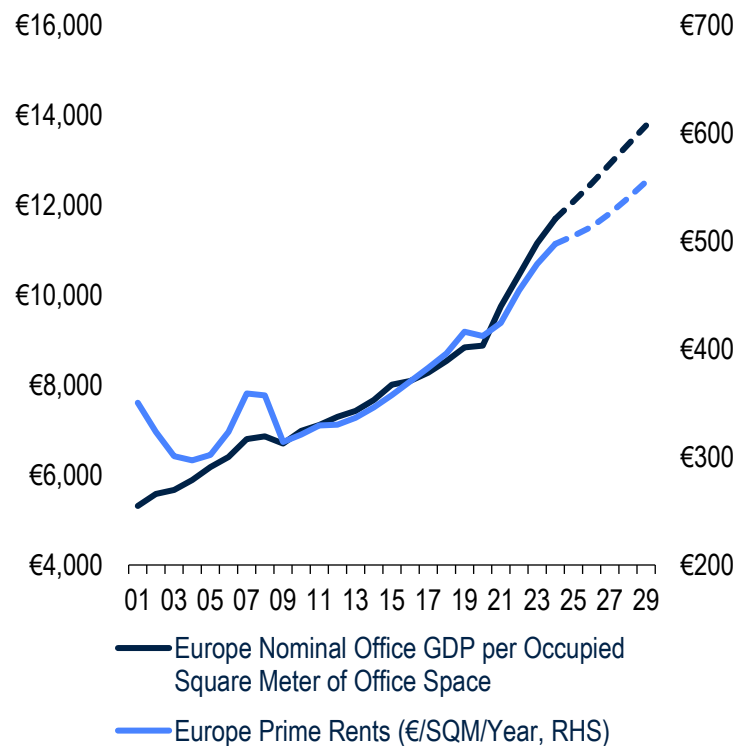
Paris and Southern European markets have recorded the strongest performance on the back of a rebound in international travel flows, but RevPAR growth is set to even up at elevated levels as demand patterns normalize.

Forecasts are not guaranteed and may not be a reliable indicator of future results.
Sources: PMA, PGIM Real Estate. As of November 2024.

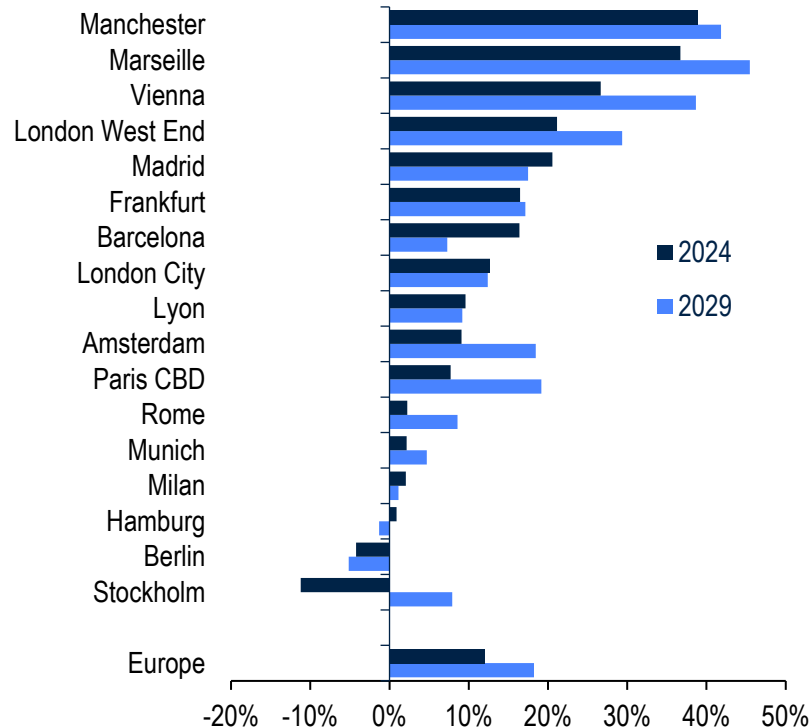


Office: Target Prime CBD Markets to Capture Benefits of Improved Affordability

Europe Office Output vs. Rents



Affordability vs. Long-Term Average Affordability



On our measures, output per square meter of occupied office space has grown faster than prime headline rents, which, in effect, means occupiers are able to afford higher rents keeping all other things equal.

This means that there is significant potential for office rents to rise in the UK, Spain and Frankfurt. However, in Stockholm and Berlin, affordability looks stretched.

Forecasts are not guaranteed and may not be a reliable indicator of future results. Sources: Oxford Economics, PMA, PGIM Real Estate. As of November 2024.

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