BNP PARIBAS REAL ESTATE

Real Estate
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RESEARCH

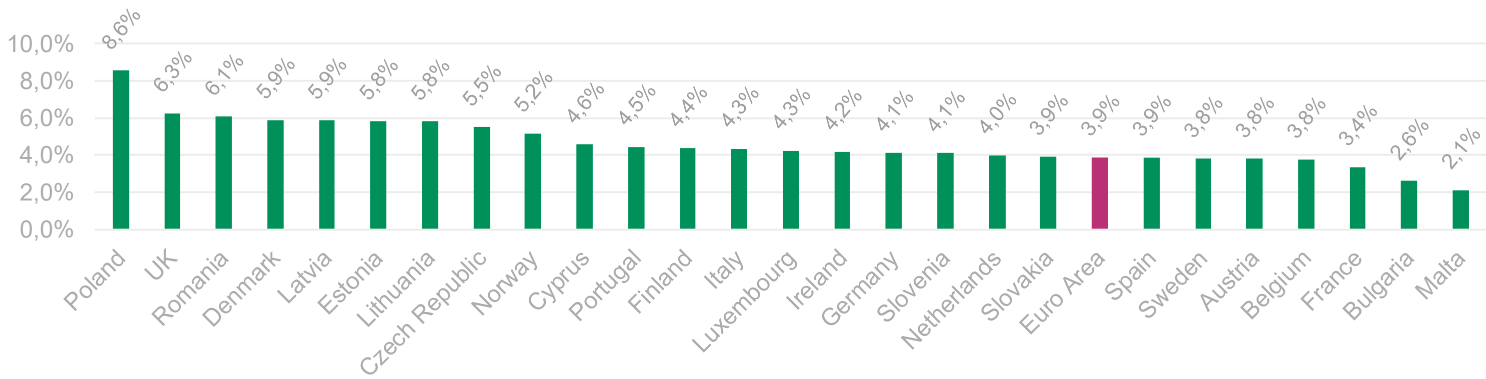
AT A GLANCE H1 2023

European residential markets

THE PIVOT IN ECB MONETARY POLICY IS TRIGGERING THE REVERSAL IN THE HOUSING CYCLE.

SIGNIFICANT RISE IN MORTGAGE RATES

Mortgage rates

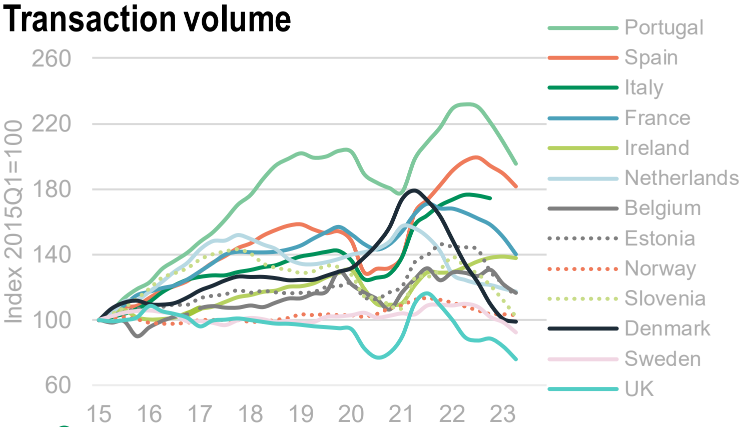


- The Governing Council decided to pause interest rates hikes in October. Consequently, interest rates are stable for the main refinancing operations (4.5%), marginal lending facility (4.75%) and the deposit facility (4.0%).
- The average mortgage rate in Europe has risen from 1.31% at the end of 2021 to 3.9% in Q3 2023: +258bps in 7 quarters. The largest increases are observed in the United Kingdom (+415 bps), Estonia (+377bps), Lithuania (+374 bps), Portugal (+366 bps), Poland (+359 bps), Finland (+358 bps), Latvia (+353 bps) and Denmark (+340 bps).
- The decision to keep interest rates stable reduced pressure on the Euribor 12 months that closed in October at 4.05% after 4.23% in September. However, we expect mortgage rates to carry on increasing to reach the 4.0% threshold by the end of the year.

TRANSACTIONS ARE FALLING

- Housing transaction volume dropped by 19.0% in H1 2023 on a rolling year basis.
- The slowdown is driven by several factors: the tightening in credit conditions, the significant increase in mortgage rates and of course the constant increase in house prices over the last 8 years. Therefore, we observe a significant worsening of housing affordability triggering a decline in the number of transactions. Likewise, a wait-and-see attitude now exists, tied to the change in house price cycle.
- Housing transactions declined by 31% in the United Kingdom, 22% in Portugal and Estonia, 21% in Belgium and 20% in Estonia.

Transaction volume



3.9%

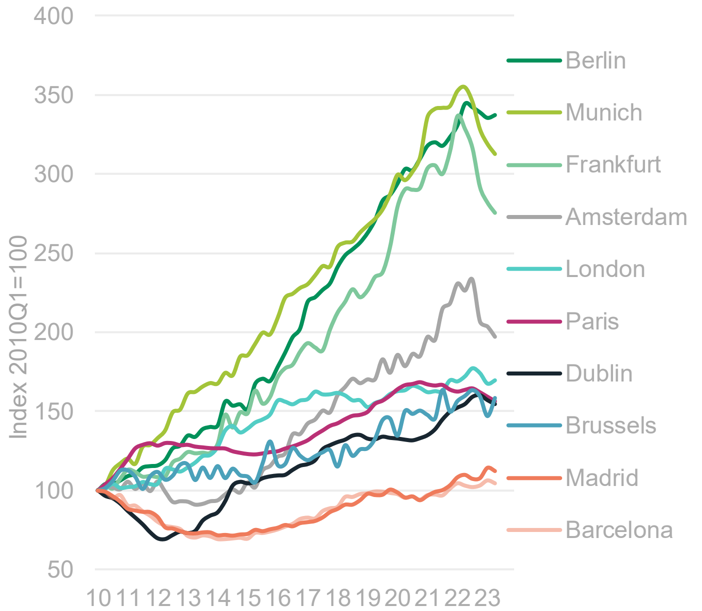
Average mortgage rates

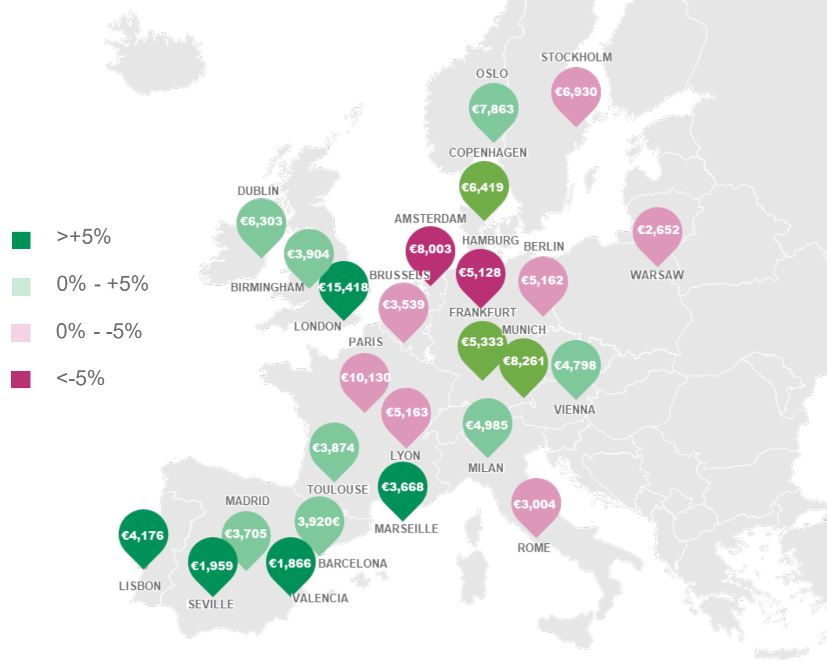
-19.0%

Over a year

HOUSE PRICES IN AN ADJUSTMENT PHASE

Residential price growth

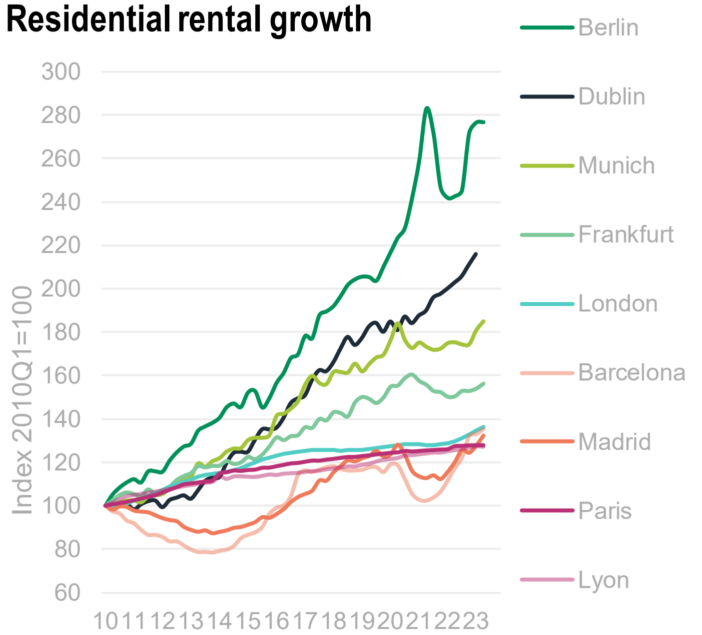


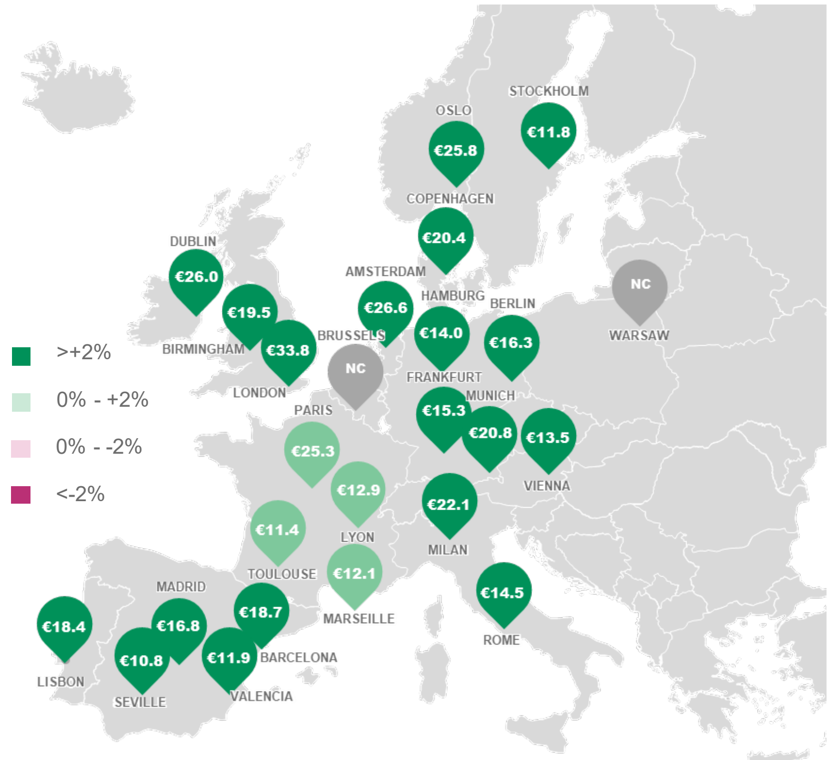


- House prices across European cities are continuing to decline in aggregate at -1.2% in Q2 2023 vs Q2 2022. Over the last year, cities that experienced double digit growth reduced from 9 in Q1 2022 to 1 in Q2 2023 - Valencia (+10.1%).
- Moreover, compared to the peak of the last 2 years, house prices are declining in 24 cities out of the 28 we monitor. For instance, house prices declined by 18% in Frankfurt, 15.4% in Amsterdam, 12.7% in Hamburg, 11.9% in Munich, 10.8% in Rotterdam.
- As a result of interest rate hikes and credit supply tightening, the housing market is cooling down and demand is in a wait-and-see attitude, moving toward cheaper markets such as suburbs.

RENTS INCREASING AS DEMAND PICKS UP

Residential rental growth



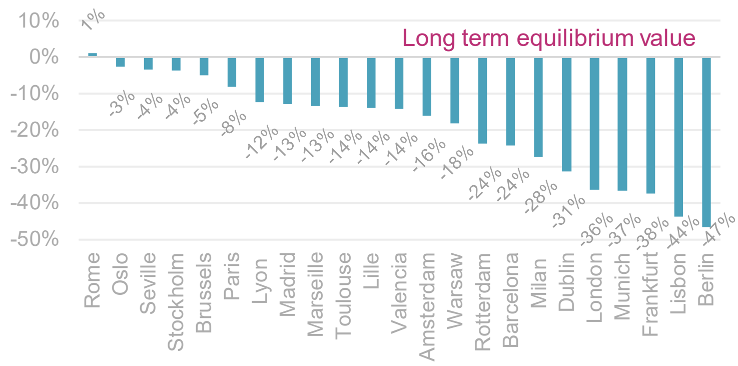


- Since the beginning of 2022, we have seen a sharp increase in demand for rental properties owing to hikes in mortgage rates and the decline in the affordability of buying. Therefore, numbers of rental dwellings listed in web platforms shrunk dramatically putting strong pressure on rental values. Finally, residential rental values across European markets are skyrocketing at +8.9% y/y.
- We record a double digit growth in 12 markets out of the 27 we monitor: Lisbon (+26%), Valencia (+21.5%), Edinburgh (+17.2%), Glasgow (+15.5%), Barcelona (+15.2%), Warsaw (+14.9%), Berlin (+14.1%) and Manchester (+10.6%). In the case of Berlin and Barcelona although rent control was removed, the rental stock shrunk dramatically because of the regulation.

DROP IN AFFORDABILITY AND RISK OF OVERVALUATION IN MOST MARKETS

- The housing purchasing power enables the computation of the volume of square meters a household can purchase earning a local median income, borrowing money over 20 years at the local mortgage rate, for a local average price per square meter.
- Likewise, if we take the overvaluation ratio (the number of square meter in Q2 2023 compared to the long-term equilibrium value), we can assess the risk of overvaluation of each market. Markets such as Roma, Brussels, Oslo, Seville and Stockholm are fairly priced because the affordability ratio remains between +5% and -5% around its equilibrium value. Nevertheless, other markets are overvalued since the affordability dramatically decreased compared to their long-term equilibrium. Concerns are arising regarding German and UK markets as well as Dublin, Milan and Lisbon with more than 30% of overvaluation vs their long-term equilibrium.

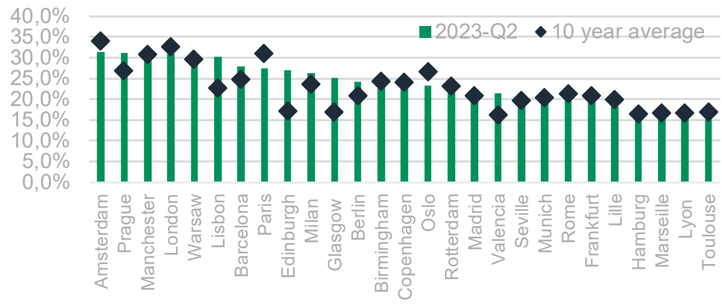
Overvaluation ratio

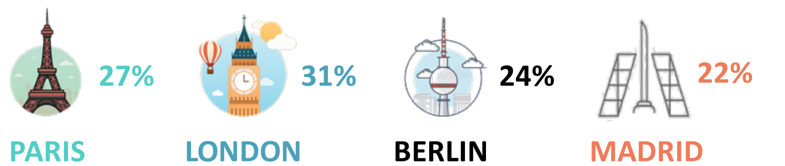


PRESSURE ON RENTAL AFFORDABILITY AS DEMAND RISING FOR THE RENTAL SECTOR

- The rental burdens represent the share of housing expenditure for a 60 sqm dwelling in the household disposable income. In Q2 2023, households dedicated on average 23.8% of their income to rent a 60 sqm dwelling i.e., +113bps increases vs the 10-year average.
- Compared to the last 10 years, the most important rise in rental burdens were recorded in Edinburgh (+10pp), Glasgow (+8.3pp), Lisbon (+7.5pp), Valencia (+5.2pp) and Warsaw (+3.4pp).
- Rental burdens in Lisbon, Warsaw, London, Manchester Prague and Amsterdam are above the 30% threshold of household income. Demand is particularly strong and still growing, worsening significantly the rental affordability.

Rental affordability (60sqm)

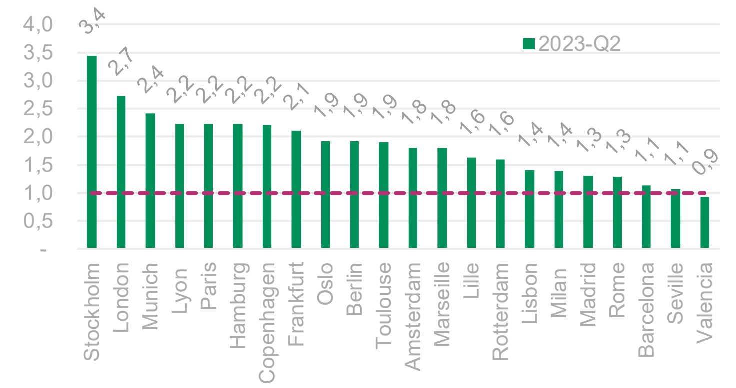




TREND TOWARDS HIGHER RENTAL DEMAND

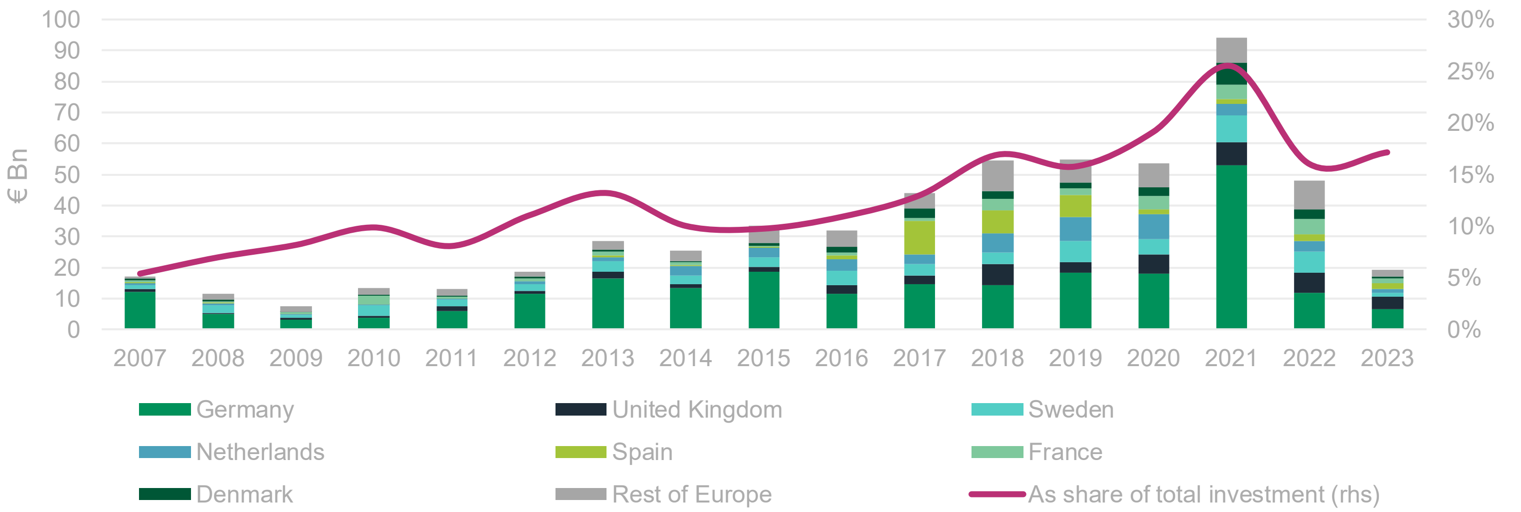
- The ratio shows that it is better to rent than buying in all markets except in Valencia. In London, Munich, Lyon Paris, Hamburg Copenhagen and Frankfurt it is more than two times more expensive to buy than to rent the purchasable area in each market. In Stockholm it is even more than three times more expensive. In Lille, Marseille, Rotterdam, Toulouse, Amsterdam, Oslo and Berlin it is between 50% and 90% more expensive to buy the purchasable area than to rent it.
- If we compare in terms of square meters, renting enable households to afford more than 50 sqm than buying in Frankfurt, Munich, Toulouse, Marseille, Hamburg, Lyon Copenhagen and Stockholm. Between 30 and 50 sqm more than buying in Rotterdam, Berlin, Paris, London, Oslo and Lille. In contrast, buying enables to afford 7 more sqm in Valencia.

Buy-vs-rent ratio



DROP IN INVESTMENT VOLUME

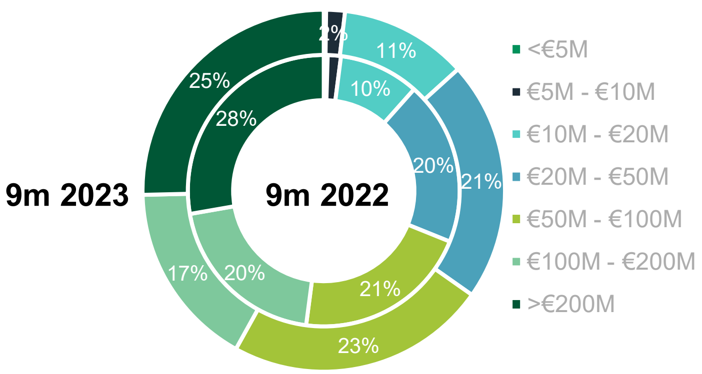
Residential investment volume



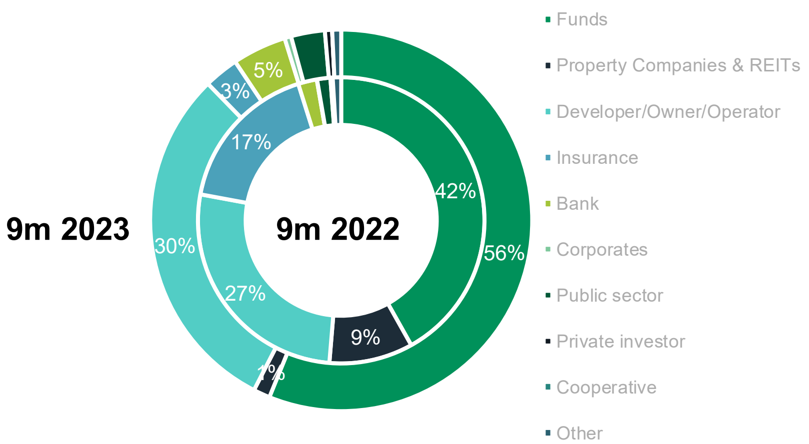
- Residential investment volumes in Europe reached €19.2bn in the first 9 months of 2023, down -54% compared to the same period last year and -45% vs the 5-year average. The residential investment in Europe is strongly impacted by interest rate hikes. Investors continue in a wait-and-see attitude despite a real interest in the asset class.
- The increases in mortgage rates and government bond yields are challenging to the investment market as they reduce the risk premium and the risk adjusted return of real estate. Hence, we expect yields to decompress and thus prices to adjust to balance the increase in the financing cost.
- Nevertheless, the underlying residential fundamentals are still very positive. We observe a strong disequilibrium between demand and supply in large urban cities. In these locations there is positive population and income growth and upwards pressure in the rental market, magnified by inflation and the shift in the monetary policy.

FUNDS AND DEVELOPERS ARE THE MOST ACTIVE PLAYERS

Breakdown in volume



Buyers' typology



- Over the 9 months of 2023, we record a total of 434 deals vs 923 deals over the same period last year, which represents a decline of 53% in the number of transactions.
- Transactions greater than €100M represent 7.2% of the total of transactions on the market. We recorded a total of 31 deals greater than €100M vs 82 last year, a fall of 62%. For the segment €50-€100M we record a total of 63 transactions i.e., 15% of the total of transactions and a decline of 50% vs last year. Deals between €10M-€20M and €20M-€50M represent 35% and 31% respectively of all transactions. However, we recorded 154 deals for the €10M-€20M segment (-46%) and 133 deals for the €20M-€50M segment (-49%). Deals below €10M represents 12% of total transactions. We record a total of 53 transactions, a decline of 68% vs the same period last year.
- In a context of economic and financial uncertainties, investors seem to be more discretionary focusing essentially on specific buildings than portfolios.
- Over the first 9 months of 2023, Funds (56%) and Developer/Owner/Operator (30%) were the most active players in the market.

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