

EUROPE CRE 180

ECONOMIC OUTLOOK

REAL ESTATE PERSPECTIVES

GLOBAL RESEARCH

April 2023



BNP PARIBAS
REAL ESTATE

Real Estate for a changing world

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EXECUTIVE SUMMARY

IN A NUTSHELL

MODEST GROWTH IN EUROPE

In March, economic conditions in the major OECD economies remained favorable to limited expansion. In Europe, we are still seeing catch-up effects in energy-intensive sectors and the labour market remains resilient to current economic shocks.

However, we are still cautious as there are lots of uncertainties in the global economy. Growth remains finely balanced against recession.

DISINFLATION: A SLOW PROCESS

Inflation barely slowed in February (8.5% YoY, after reaching 8.6% in January) as the drop in the contribution of the energy was offset by the increase in food and services prices. As a result, the ECB should continue to increase rates over the mid-part of the year.

INVESTMENT PLUMMETING

The rapid acceleration in financing costs from mid-2022 destabilized pricing in the market, resulting in investment plummeting by Q4 as buyers and sellers pulled back. Over the 12 months ending with Q1 2023, investment reached €219 almost reaching Q1 2021's low point.

Overall, between Q1 2022 and Q1 2023, investment decreased by 60%. All asset classes experienced a strong reduction.

YIELDS ARE EXPANDING

Bond yields are growing very rapidly, reducing the yield gap with real estate and prompting rethinking about the prices being paid for assets.

Mid-2022 showed the first signs of expansion that have strengthened since. Decompression is affecting all the main sectors of real estate.

OFFICE LETTING ACTIVITY: A QUIET START TO 2023

While 2022's overall take-up returned to its long-term average in Europe, the contraction noticeable in few markets at the end of 2022 extended across Europe in early 2023. Take-up at the end of Q1 2023 shrank 23% relative to Q1 2022.

Most markets have experienced decline in volumes, mostly due to a reduced number of very large transactions.

AN INCREASING FOCUS ON QUALITY OVER QUANTITY

With the widespread uptake of hybrid work models, companies are seeking attractive and modular workplaces offering greater connectivity. Demand is also high for energy-efficient and sustainable buildings. These increasing quality requirements drive values up in the most sought-after markets and has widened the gap between prime and average rental values.

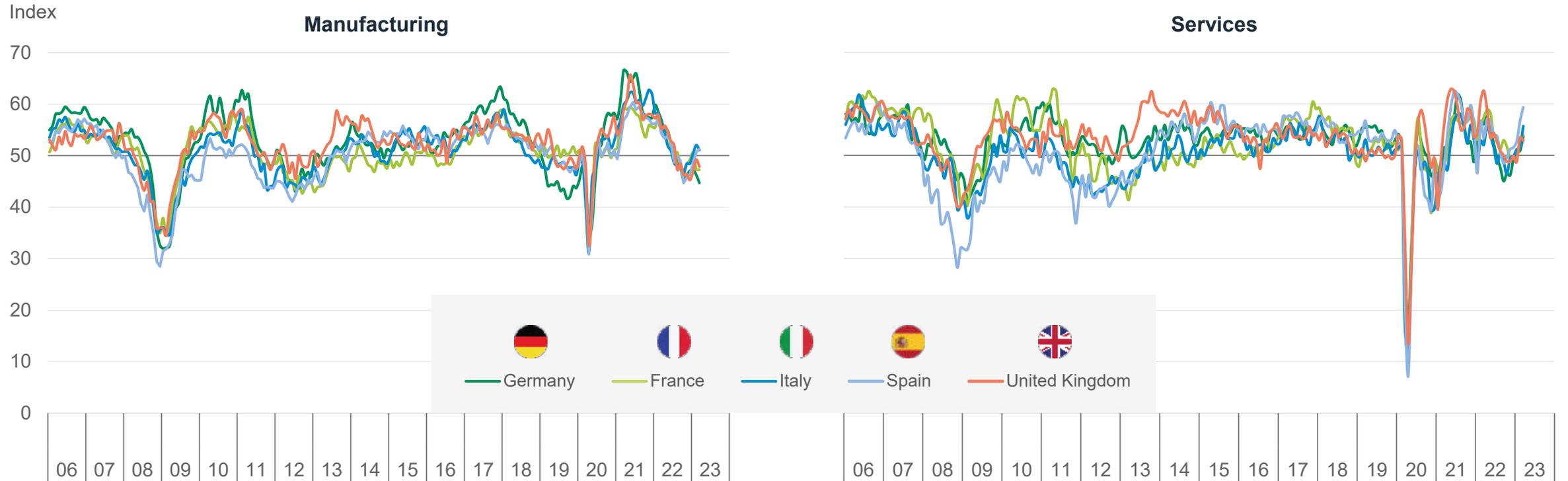
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ECONOMIC OUTLOOK



PURCHASING MANAGER INDEX SURVEYS

DIVERGENCE BETWEEN INDUSTRY AND SERVICES



Sources: S&P, BNP Paribas Economic Research.

Strong divergence between manufacturing and services

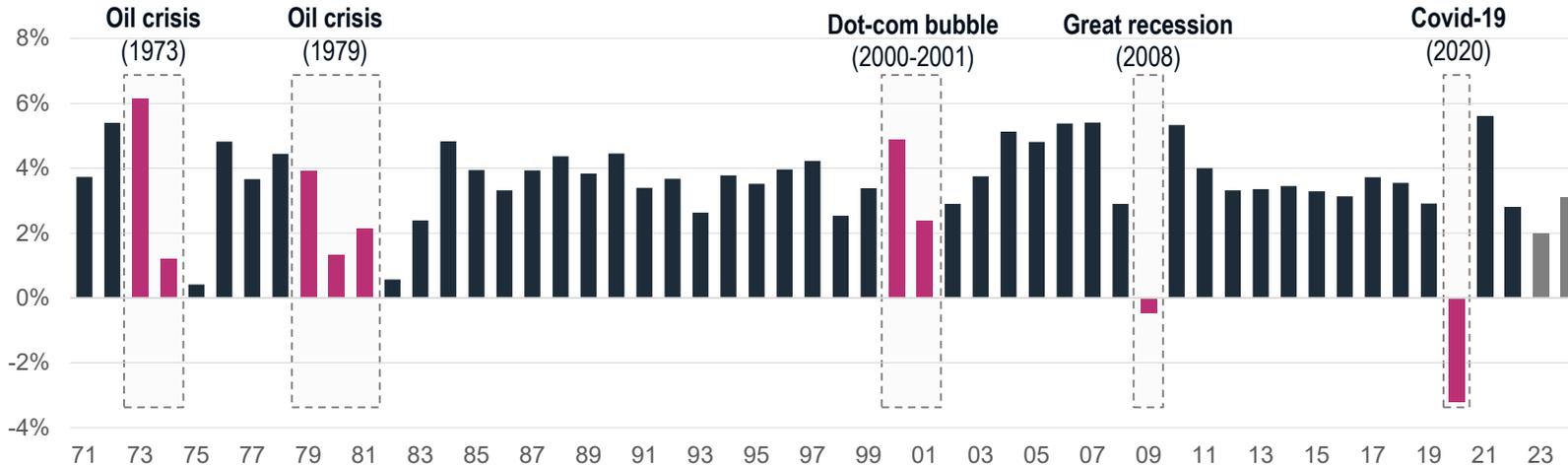
PMI indices indicate that overall activity is not faltering: the composite index rose from 53.7 to 54.4 in April 2023. The manufacturing PMI fell further in contractionary territory to 45.5 from 47.3 in March, while the services index rose again to 56.6, the best reading in a year.

The growing gap between the industry and services indicators raises questions about the nature of the current economic cycle. The service sector leads expansion whilst manufacturing is starting to feel the effects of slower demand. Though improved delivery times in the supply chain allowed fulfillment of existing orders, new orders maybe weakening

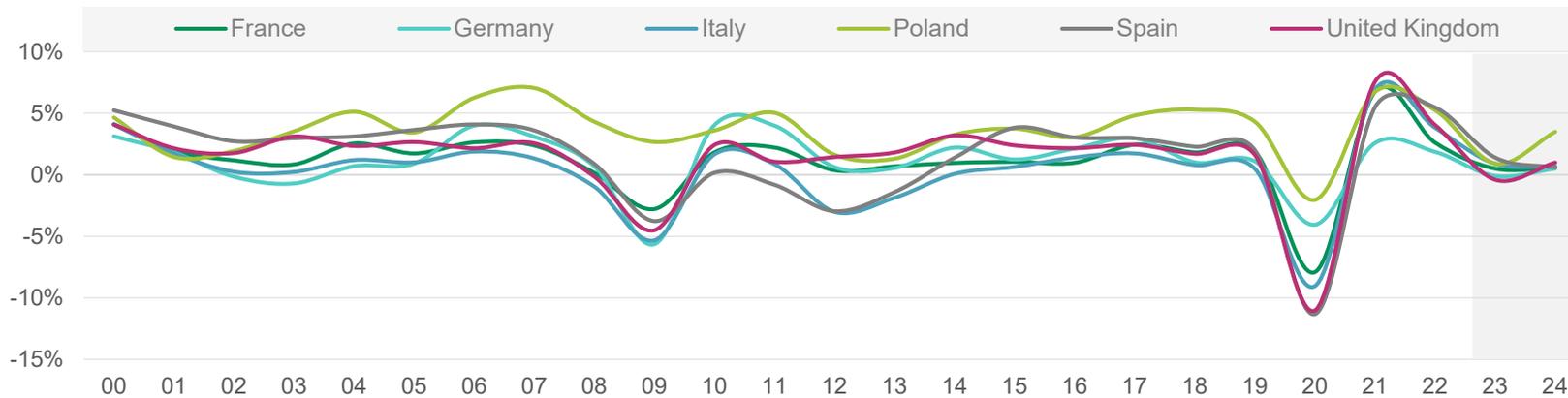
ECONOMIC OUTLOOK

WHAT OUTLOOK FOR THE MAIN ECONOMIES?

World GDP



GDP growth in European countries



Sources: BNP Paribas Real Estate, OECD.

Slower activity has a number of causes

- After a year characterized by an inflationary shock and a bond crash, 2023 will not escape a slowdown in activity. There are roll over factors from 2022 that may dampen output:

- The invasion of Ukraine by Russia may continue to shape energy and commodity prices. Its main impact in 2023 is to impose energy transition costs that may act as a drag on output
- The reopening of the Chinese economy following abandonment of zero-Covid will take time to feed into the global economy, particularly through supply chains
- Monetary tightening from the main central banks is likely to sustain over 2023 with no loosening

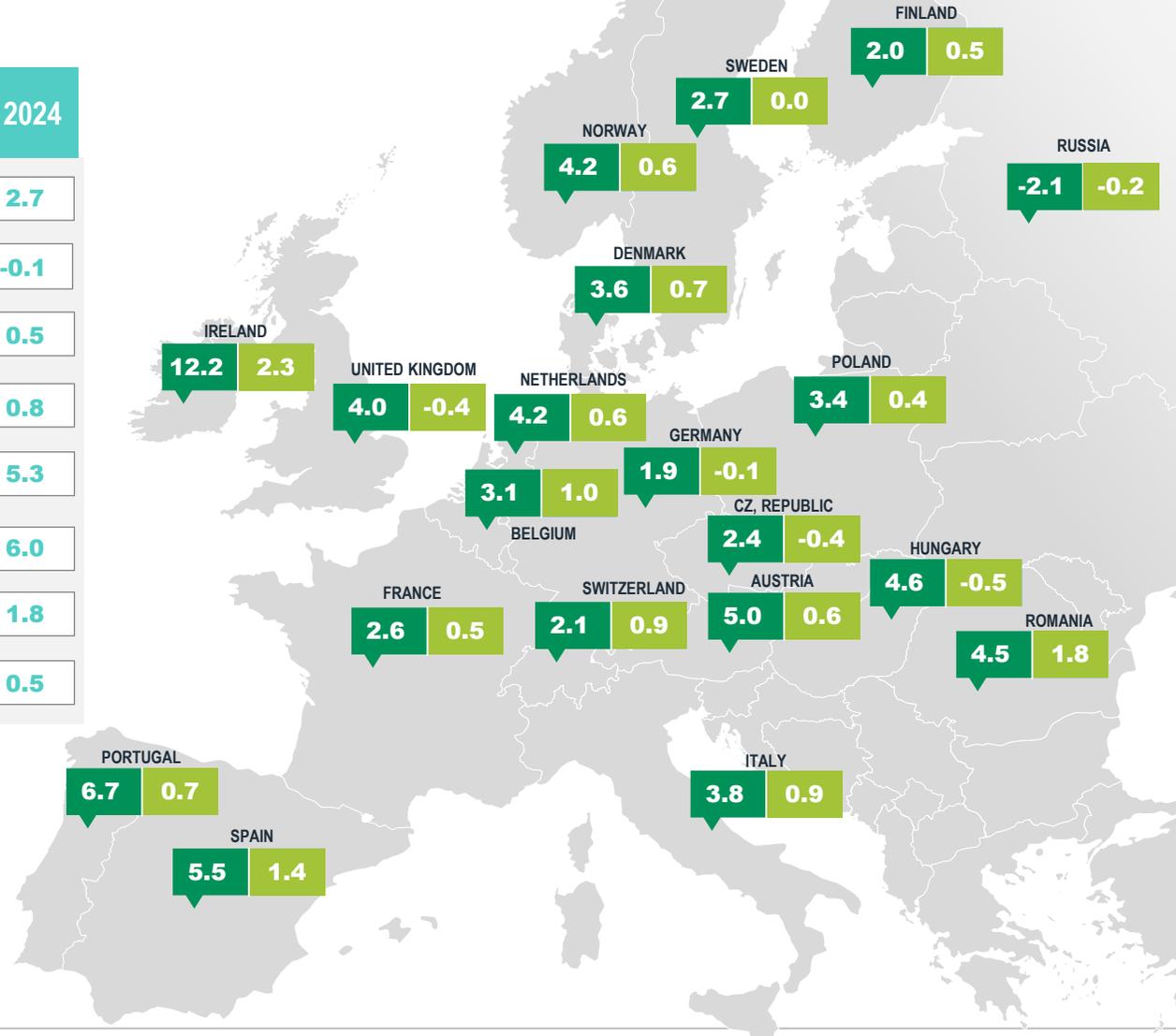
Lower growth for Europe

- Despite the current uncertainties, we expect positive growth in Europe. Indeed, the limited rise in unemployment, the support from fiscal policy in many European countries and the need to invest in the context of the energy transition should limit the economic shock.
- Nonetheless, the economy remains finely balanced between recession and expansion and could tilt either way. It is greatly dependant on the policy response from the ECB.
- Overall, we may see weak to moderate growth in Europe in 2023 (0.7%).

GDP GROWTH IN EUROPE

RESILIENT ECONOMIC GROWTH

FORECAST (%):	2022	2023	2024
World	3.1	2.2	2.7
United States	2.1	1.4	-0.1
Euro area	3.5	0.7	0.5
Japan	1.0	1.2	0.8
China	3.0	5.6	5.3
India	7.0	5.7	6.0
Russia	-2.1	-0.2	1.8
Brasil	2.9	1.5	0.5



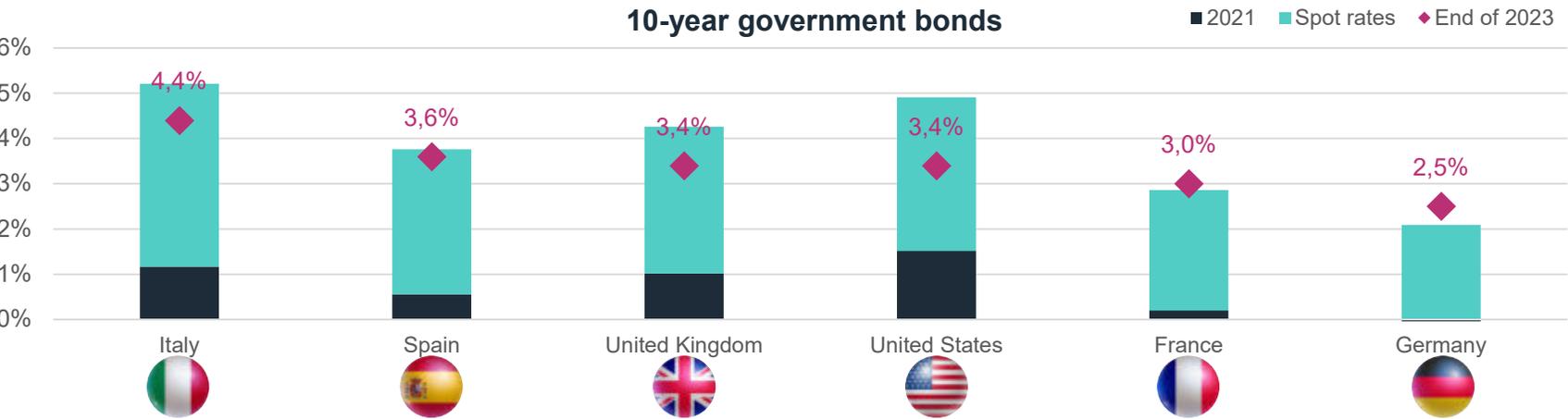
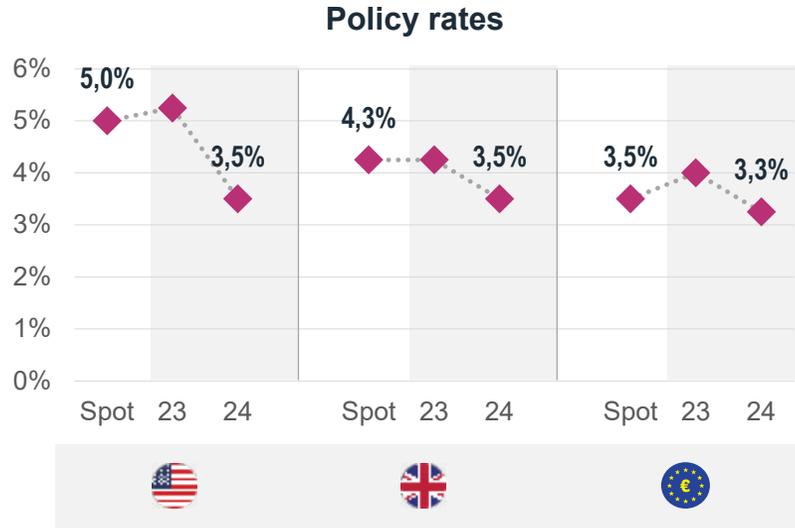
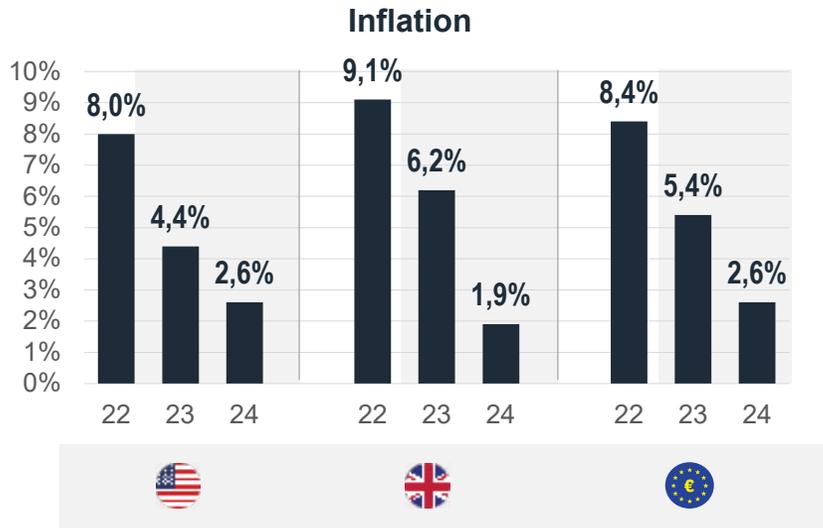
A more resilient economic scenario

- In March, economic conditions in the major OECD economies remained favorable towards some expansion.
- While in the US, the growth momentum is continuing, Europe is still benefitting from catch-up effects in the energy-intensive sectors and in transport equipment (which is benefitting from reduction in supply difficulties).
- China's economic activity started to rebound in late January, driven primarily by services and household consumption.
- According to our forecasts, the outlook for growth in 2023 is fairly mixed: from the United Kingdom (where negative growth cannot yet be ruled out) to the United States and Japan (where growth should be clearly positive).
- The Eurozone should experience lower growth. While a recession is unlikely for 2023, growth is still incredibly fragile. Unemployment remains at record lows, fueling labour shortages and faster wage increases.

Source: BNP Paribas Real Estate Research.

FINANCIAL OUTLOOK

ECONOMIC AND FINANCIAL INDICATORS



Sources: BNP Paribas Economic Research, OECD.

Normalization in monetary policy

- The decline in energy inflation has led to disinflation in the headline rate. This is relative, as core inflation has not declined to the same extent in either the US or Europe. Food inflation is a key driver having reached new heights in Europe.
- As a result, the recovery in household confidence remains very moderate and is not yet reflected in the willingness to buy in many countries.
- In the US, the Federal Reserve should continue its tightening policy. Given the current economic uncertainties, we expect the terminal rate to be lower than previously expected, at 5.25% (upper range).
- The ECB should also continue to increase interest rates, with the deposit facility rate peaking at 3.5% (and the refinancing rate peaking at 4.0%) in June.
- The ECB is waiting for cooler wage growth and clearer signs of lower core inflation before ending the rate cycle. The new rates will maintain through the rest of 2023 with no cuts until 2024.
- In the near-term, there is some upward potential for long term rates. As 2023 moves to its end, yields may move lower as the inflation outlook improves and the market starts anticipating policy easing in 2024.

INFLATION IN EUROPE

WAITING FOR MORE SIGNIFICANT DISINFLATION



Source: Macrobond.

Disinflation is a slow process

- The preliminary inflation numbers for February had the effect of a cold shower on hopes that prices were under control due to the acceleration of core inflation.
- Inflation barely slowed in February (8.5% YoY, after reaching 8.6% in January) as the drop in the contribution of the energy was offset by the increase from the food component and services prices.
- As a result, the inflation rate should remain significantly above the target of 2% by the end of 2023.
- The disinflationary trend should continue in the coming month albeit at a slow pace. On the supply side, the delivery times index is now at a record level as supply chain pressures have eased. In addition, lower prices might be expected as demand is just starting to weaken.

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REAL ESTATE PERSPECTIVES



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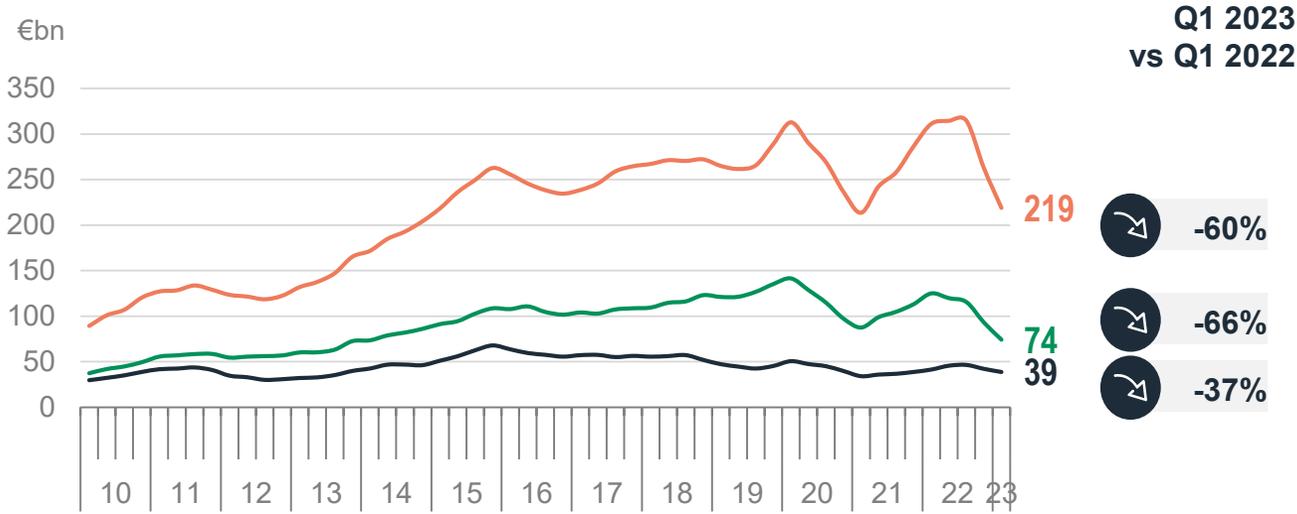
REAL ESTATE PERSPECTIVES

COMMERCIAL REAL ESTATE
INVESTMENT MARKETS



INVESTMENT IN COMMERCIAL REAL ESTATE IN EUROPE

BREAKDOWN OF INVESTMENT BY ASSET CLASS



Investment scales back as buyers and sellers assess pricing

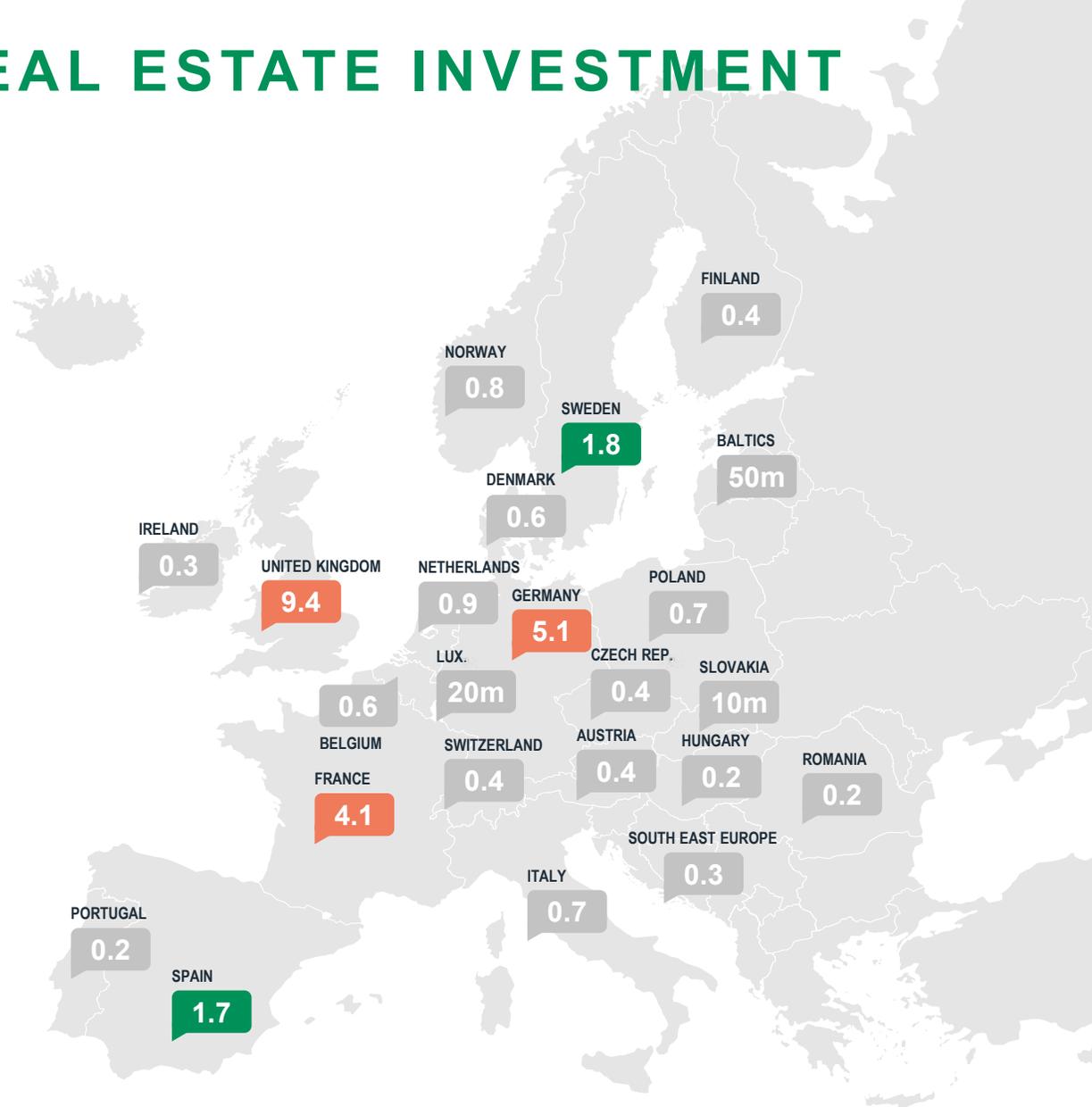
- Investment reached a high of €313bn in Q2 2022, almost touching Q1 2020's record (€314bn). The Ukraine war triggered the economic turmoil that led to the sharpest fall back in market activity in a decade.
- The rapid acceleration in financing costs from mid-2022, destabilized pricing in the market resulting in investment plummeting by Q4 as buyers and sellers pulled back. Over the 12 months ending with Q1 2023, investment reached €219 almost reaching Q1 2021's low point.
- Overall, between Q1 2022 and Q1 2023, investment decreased by 60%. All asset classes experienced a strong reduction. Logistics (-71%) was the most affected as prices were already expensive before problems arose. Offices (-66%) suffered as well as complicated pricing adds difficulties to a sector where structural change seems to be underway. Hotels (-21%) and retail (-37%) incurred the least declines.



This excludes residential investment.

COMMERCIAL REAL ESTATE INVESTMENT

Q1 2023 vs Q1 2022



- €29.0bn were invested in Europe over 2022, which represents a 60% decrease vs Q1 2021.
- All countries experienced decline: Germany (-74%), the UK (-58%) and France to a lesser extent (-25%) largely due peaking earlier in 2022. Italy (-74%), the Netherlands (-73%), Belgium and Poland (-69%) saw their investment drop back while declines in Spain (-38%) and Ireland (-23%)'s were of lower magnitude.

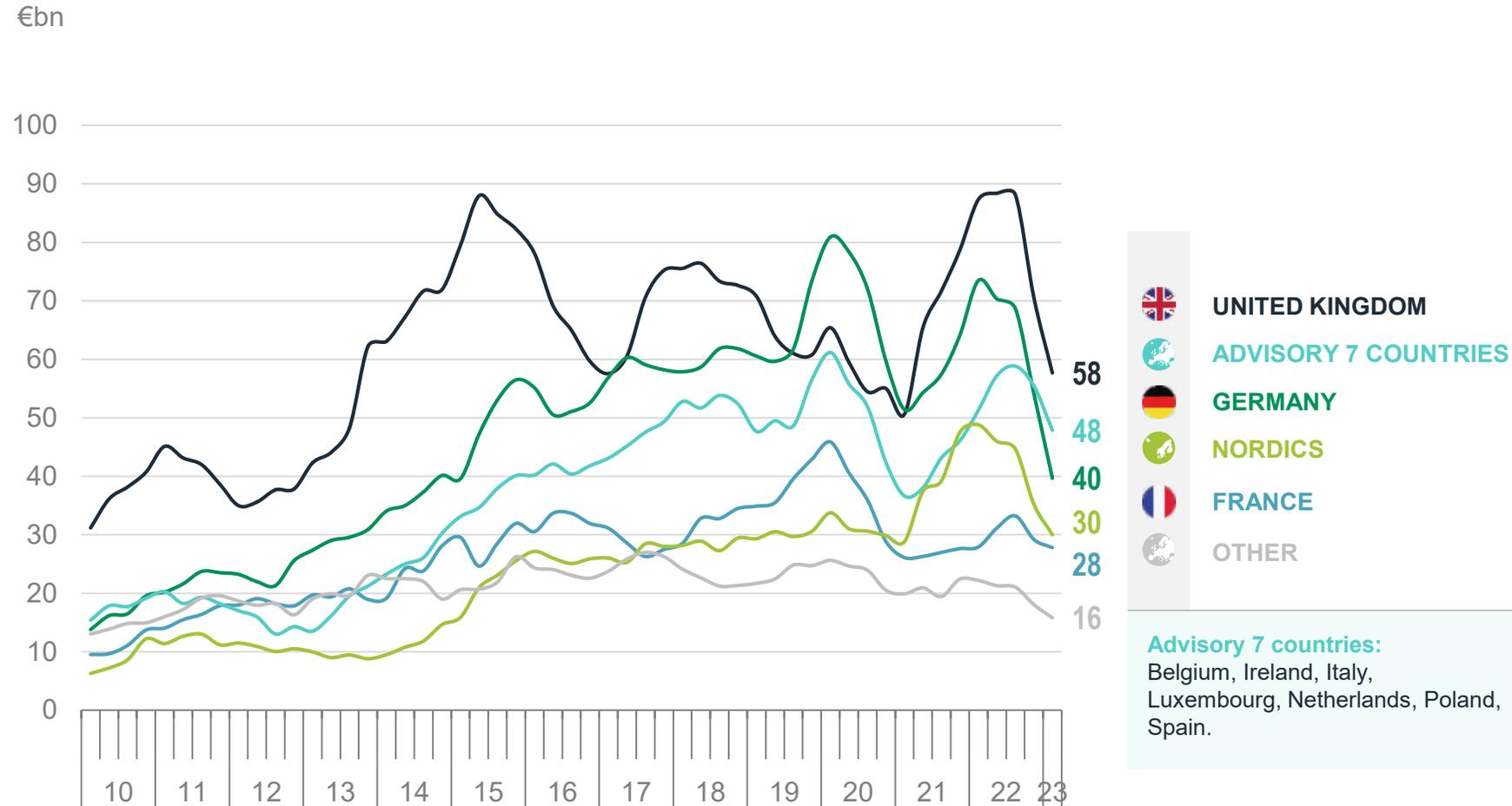
(excludes residential investment)

Source : BNP Paribas Real Estate

COMMERCIAL REAL ESTATE INVESTMENT VOLUME

INVESTMENT REMAINS HIGH EVEN WITH BUYER CAUTION

CRE Investment volume (€ billion)



Source: BNP Paribas Real Estate Research.

- Early 2022, markets were posting investment volumes similar to pre-pandemic levels.
- From mid 2022, high inflation and subsequent acceleration in monetary policy tightening, resulted in rapid bond yield expansion. As this situation has not yet stabilized, extensive pricing uncertainty in real estate now exists. It is also creating difficulty in lending which is now more expensive.
- The outcome is that a more selective approach to property from buyers emerged at the end of 2022. All countries are now trending down in absolute investment volumes.

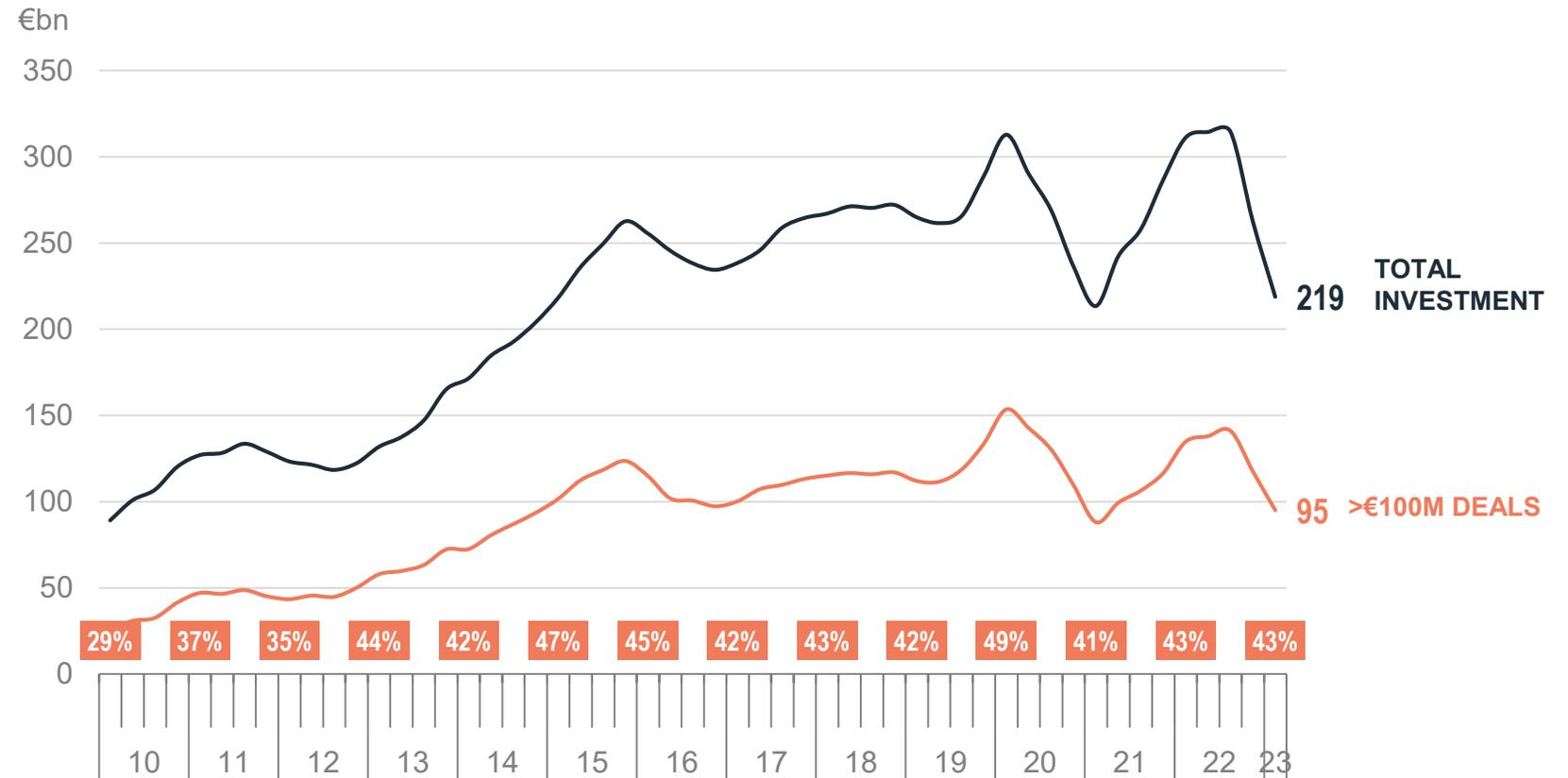
INVESTMENT BY SIZE BAND

Mega deals also scaling back

- The peak in mega deals (>€100m) occurred in Q1 2020 with a record figure of €155bn (on a rolling-year basis). That is 49% of the total investment, an unusually big share for a Q1 and may not reappear for the time being.
- The pandemic induced low point occurred of €89bn occurred in Q1 2021. This was down 43% over Q1 2020 figure. Prior to global interest rate cycle tightening, the segment was regaining momentum reaching €141bn at Q3 2022.
- The mega deals volume dropped over Q4 2022 but to a lesser extent than other size bands of deals. The delayed response to interest rates may be a timing issue as these sort of deals take a long time to complete. Consequently the share of mega deals increased (46%).

Commercial Real Estate Investment in Europe

Total and >€100m size band - volume and share



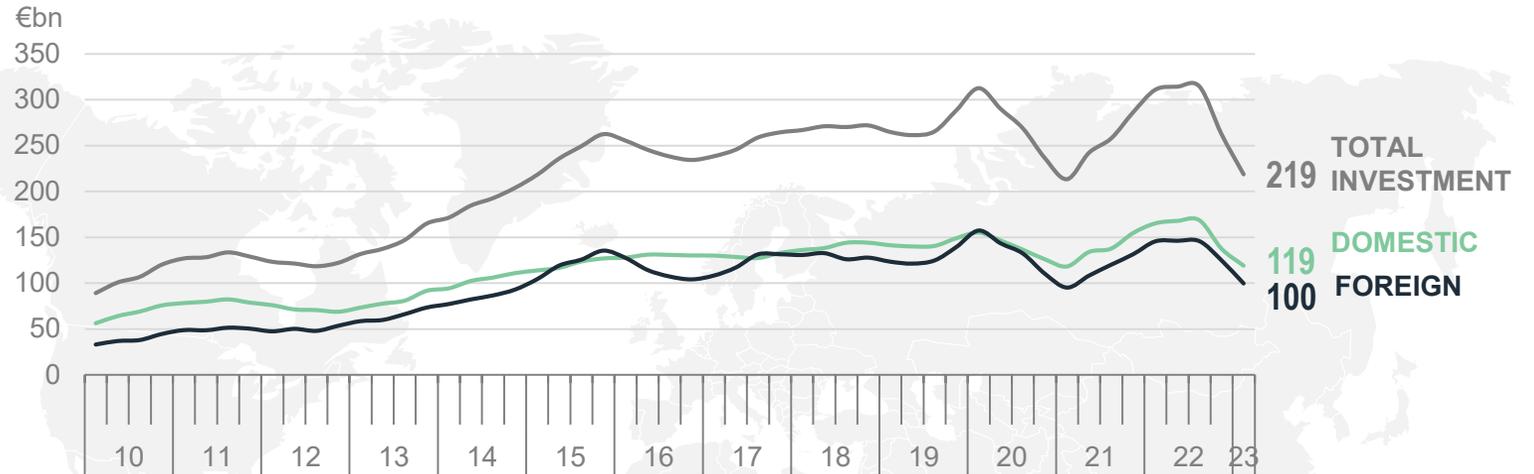
Source: BNP Paribas Real Estate.

CROSS-BORDER INVESTMENT MARKET

- Over 2022, foreign investment was very high during the 3 first quarters, peaking at €146bn (on a rolling-year basis) in Q2. It then declined sharply over Q4 reaching €100bn in Q1 2023 (-32%).
- Within foreign investment, **European cross-border investment declined in line with the overall reduction in activity (-30%)**. It represents 42% of foreign investment, a smaller share than during the Covid-19 years, but still above pre-pandemic times.
- Investment from other continents shows contrasting developments. **American investors** showed less interest in the European market (-37%) but are still very present with 33% of foreign investment.
- Investments from Asia Pacific were also very important over the 12 last months. **With more than €13bn invested, (-6%)**, Asian investor share increased slightly (13%).
- Middle East investors are less interested in the European market compared to Americans and Asians. **They only represented 3% of the last 12 months foreign investment with €2.8bn invested (-14%)**.

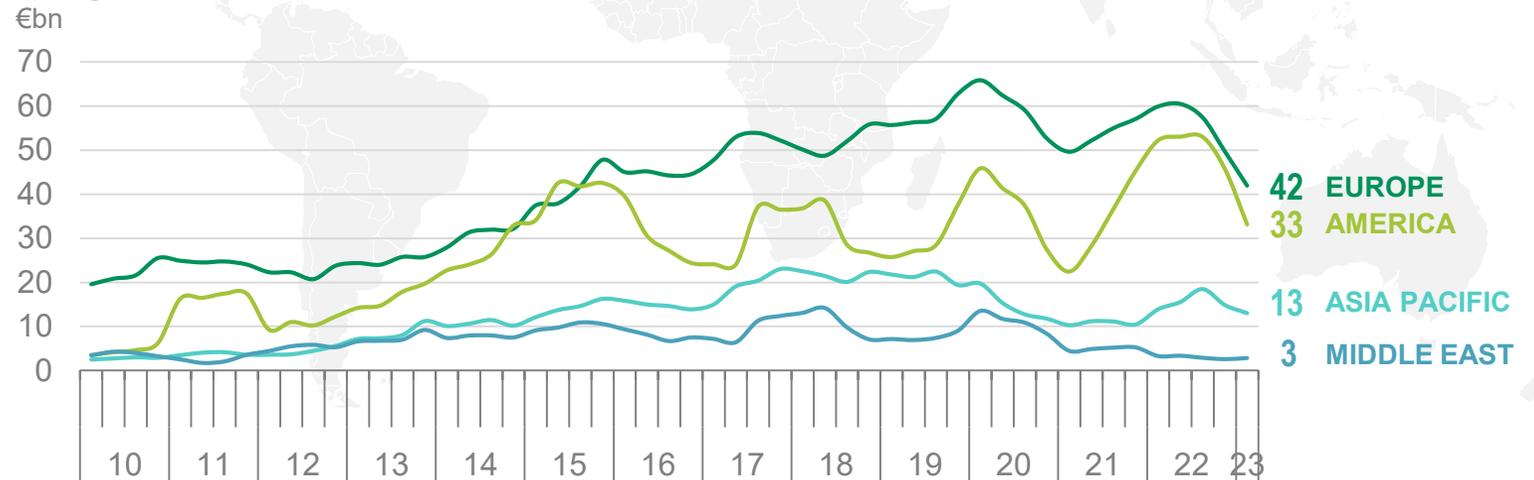
Commercial Real Estate Investment in Europe

Total, foreign and domestic investment



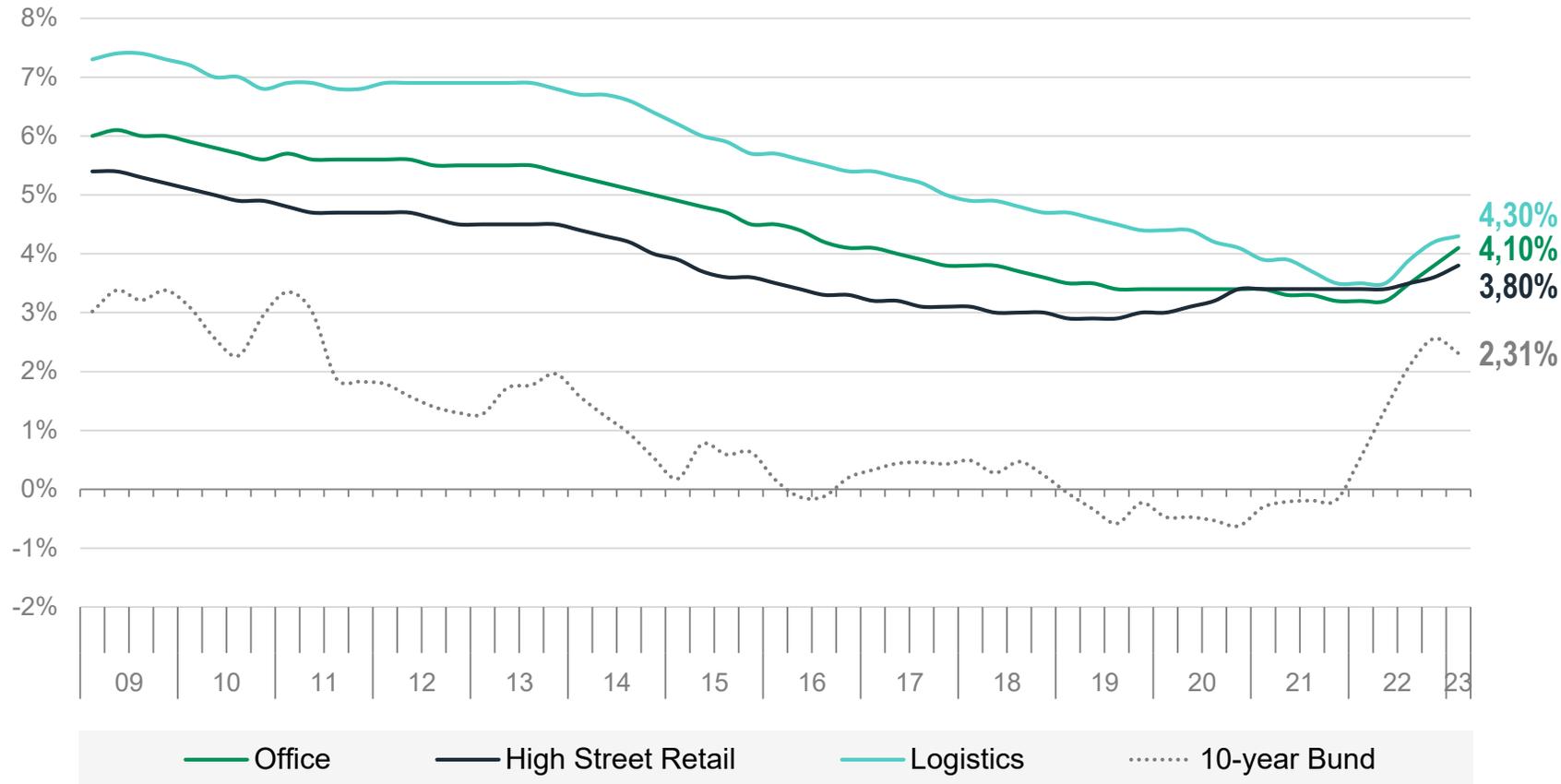
Commercial Real Estate Investment in Europe

Foreign investment detail



AVERAGE PRIME YIELDS IN EUROPE

BASED ON 16 MARKETS



- Prime yield compression, came to an end in 2022 closing off ten years of declines.
- Mid-2022 showed the first signs of expansion that have strengthened since. Decompression is affecting all the main sectors of real estate.
- The principal factor behind yield expansion is the change in the macro-financial environment. Persistent inflation is prompting more robust response from central banks. It is accelerating normalization of monetary policy.
- Bond yields are subsequently growing very rapidly, reducing the yield gap with real estate and prompting rethinking about the prices being paid for assets.

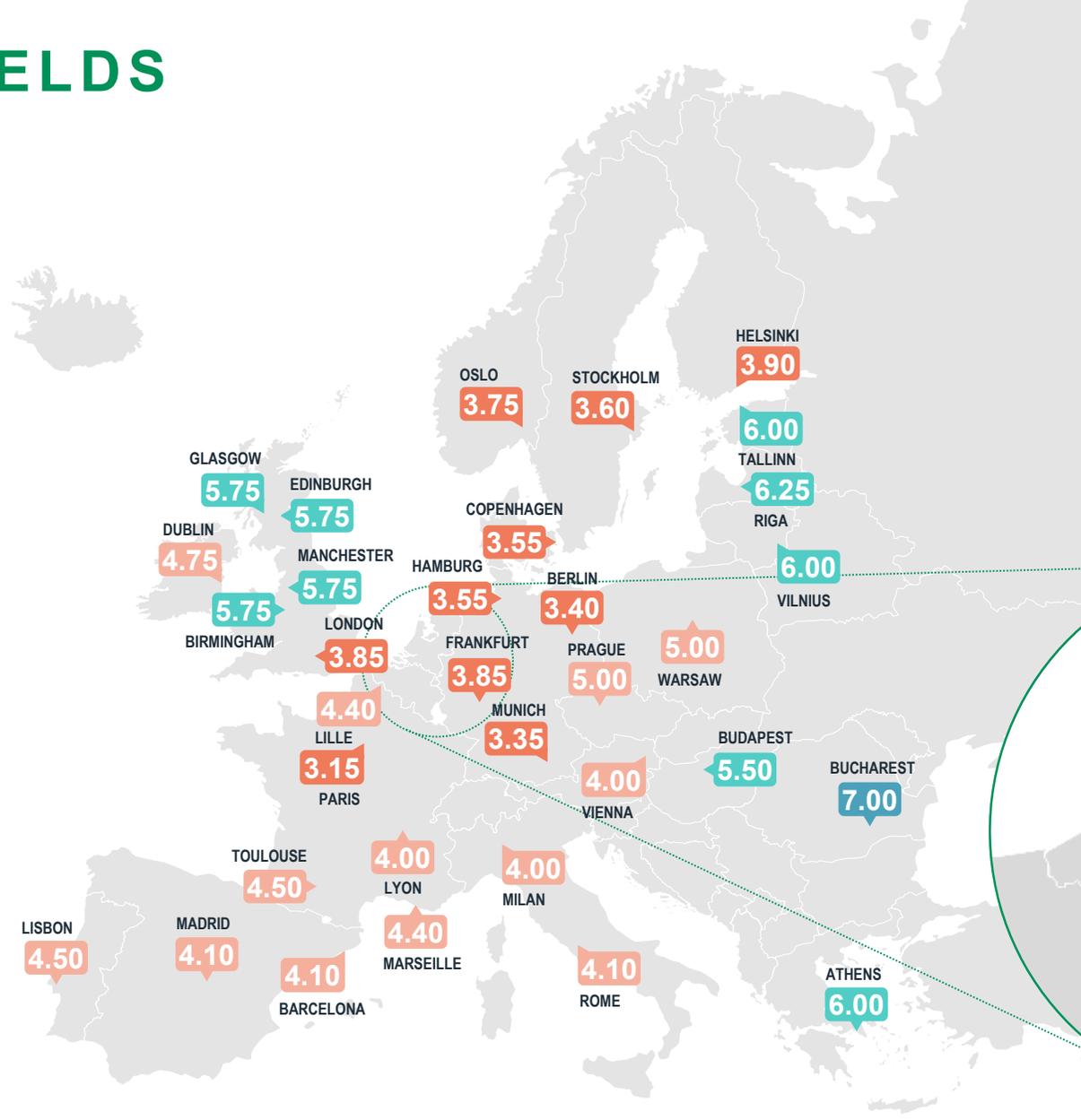
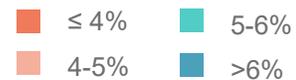
Based on 16 cities: Amsterdam, Berlin, Brussels, London, Paris, Dublin, Frankfurt, Hamburg, Lisbon, Luxembourg, Madrid, Milan, Munich, Prague, Vienna and Warsaw.

Source: BNP Paribas Real Estate Research.

PRIME OFFICE YIELDS

Q1 2023 vs Q1 2022

	BERLIN	+100bp ↗
	PARIS	+45bp ↗
	AMSTERDAM	+120bp ↗
	MADRID	+100bp ↗
	MILAN	+100bp ↗
	LONDON	+60bp ↗
	LUXEMBOURG	+85bp ↗
	BRUSSELS	+75bp ↗
	DUBLIN	+75bp ↗
	PRAGUE	+100bp ↗
	WARSAW	+50bp ↗



Source : BNP Paribas Real Estate

- Office yield compression effectively ceased in Q1 2022. By Q2 and Q3 2022 the first signs of yield expansion were occurring, becoming strong and universal by Q4. Expansion has rolled forward into Q1 2023.
- Several markets experienced a 100bp or more expansion such as Amsterdam (+120bp), Berlin, Madrid, Milan and Prague (+100bp) since Q1 2022.

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REAL ESTATE PERSPECTIVES

OFFICE
MARKETS



OFFICE TAKE-UP IN EUROPE – 3-MONTH PERIOD

17 MAIN EUROPEAN OFFICE MARKETS *

thousand sqm



A modest start to 2023

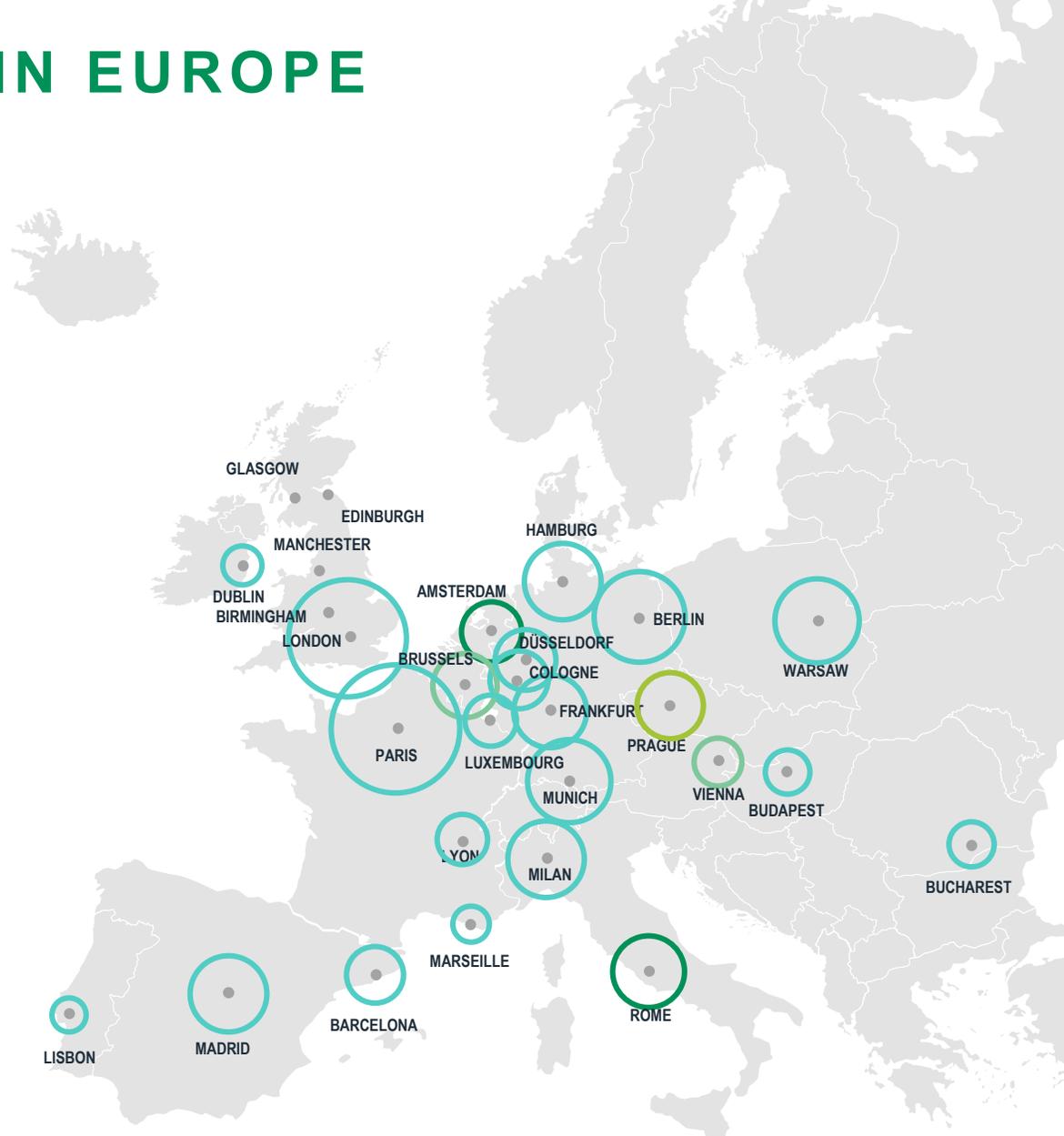
- While 2022's overall take-up returned to its long-term average in Europe, the contraction noticeable in few markets at the end of 2022 extended across Europe in Q1 2023.
- Around 1.80 m sqm transacted over Q1 23 in the 17 main European markets, decreasing by 22% vs Q1 22.
- Quarterly volumes stood at 15% below their Q1 10-year average.
- Take-up declined in many markets including Dublin (-42%), Central Paris (-36%), Warsaw (-36%) and the six main German markets (-24%).
- Rome and Amsterdam stand in contrast accelerating by 70% and 34% y.o.y respectively.

Source: BNP Paribas Real Estate Research.

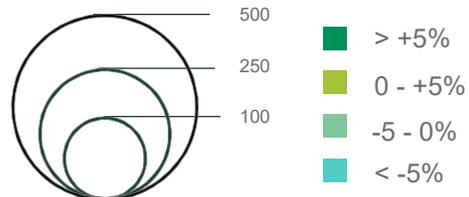
* Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, Central Paris, Central London, Brussels, Barcelona, Madrid, Dublin, Milan, Rome, Luxembourg, Amsterdam, Warsaw

OFFICE TAKE-UP IN EUROPE

Q1 2023 vs Q1 2022



Deals in thousand sqm



Source: BNP Paribas Real Estate.

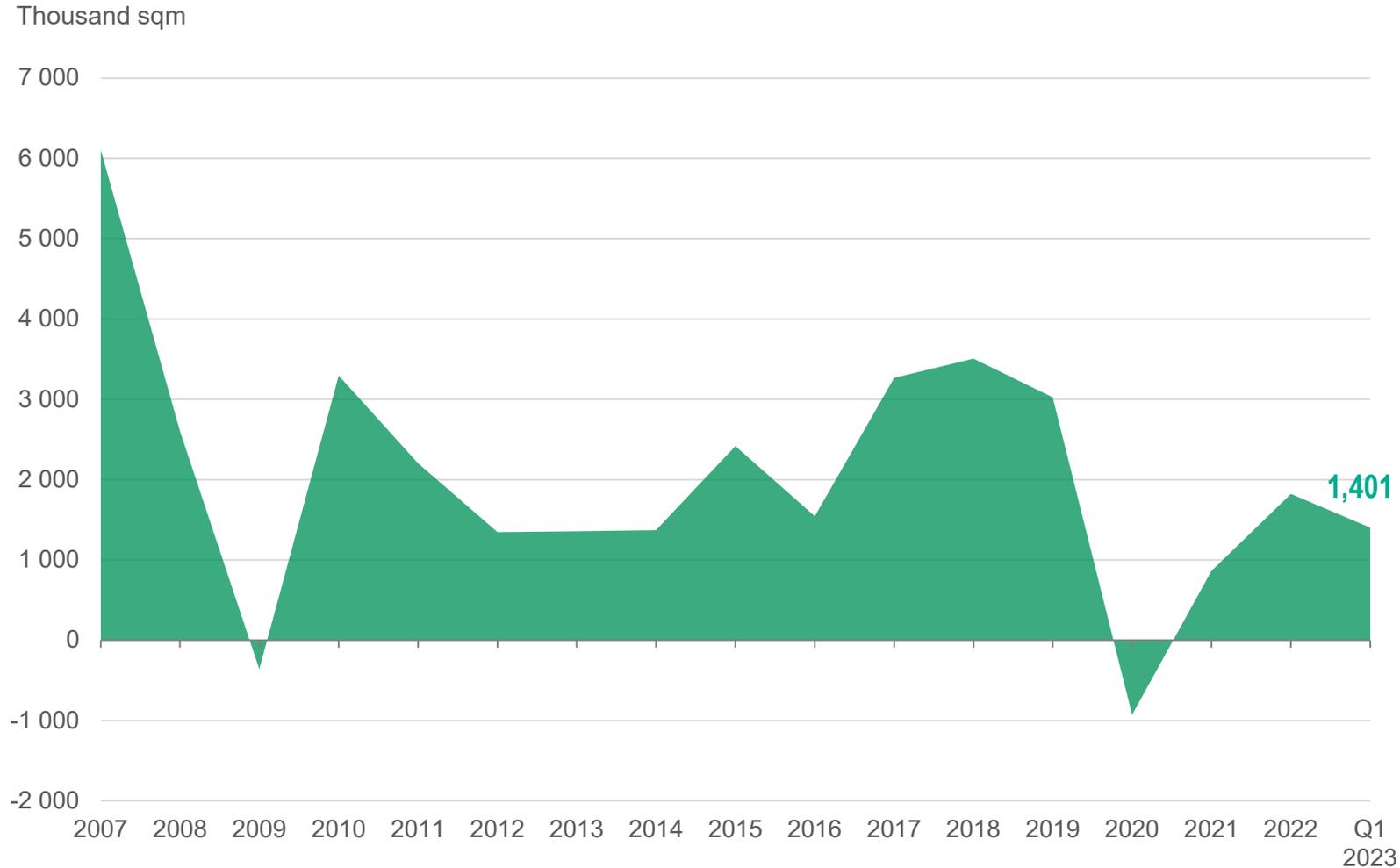


Take-up down in Q1 2023

- Take-up at the end of Q1 23 shrank 23% relative to Q1 22.
- Most markets have experienced decline in volumes, mostly due to a reduced number of very large transactions (over 10,000 sqm).
- However, a few markets have seen increase in letting activity. This occurred with Rome (+ 70%) where the volume was driven by the closure of a very large transaction to a public sector tenant.

OFFICE OCCUPIER MARKETS

NET ABSORPTION OF OFFICES



Source: BNP Paribas Real Estate Research.

Slowing net absorption of offices

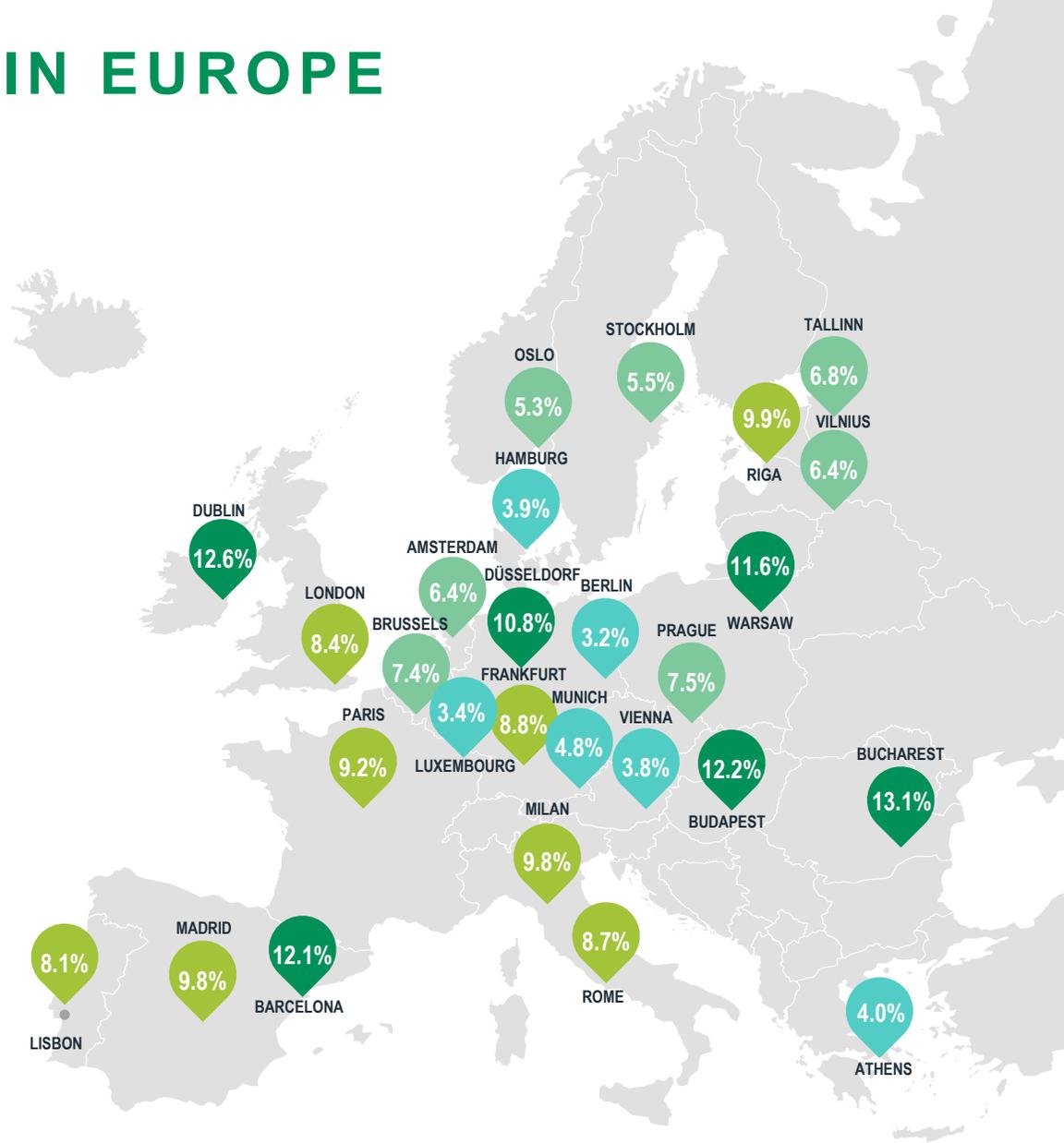
- The contraction in take-up resulted in the net absorption of offices in Europe* decreasing. It reached 1.40 million sqm (representing 0.6% of the total stock) at the end of Q1 2023.
- Net absorption remained particularly high in Dublin (97,910 sqm, 2.3%) and Berlin (380,500 sqm, 1.8%), despite a significant amount of office completions (and consequently a larger stock) over the past 12 months.
- A similar trend occurred in Milan, where net absorption stood at 206,000 sqm (1.7% of total stock), reflecting the good momentum of this market.

*Amsterdam, Barcelona, Berlin, Brussels, Dublin, Cologne, Düsseldorf, Frankfurt, Hamburg, Central London, Luxembourg, Madrid, Milan, Munich, Central Paris, Rome, Warsaw.

OFFICE VACANCY IN EUROPE

Q1 2023 vs Q1 2022

	CENTRAL LONDON	-30 bp ↘
	BERLIN	-20 bp ↘
	CENTRAL PARIS	+70 bp ↗
	AMSTERDAM	+50 bp ↗
	MADRID	= ↔
	MILAN	+20 bp ↗
	WARSAW	-60 bp ↘
	BRUSSELS	-60 bp ↘
	DUBLIN	+210 bp ↗
	LUXEMBOURG	-50 bp ↘



Source: BNP Paribas Real Estate

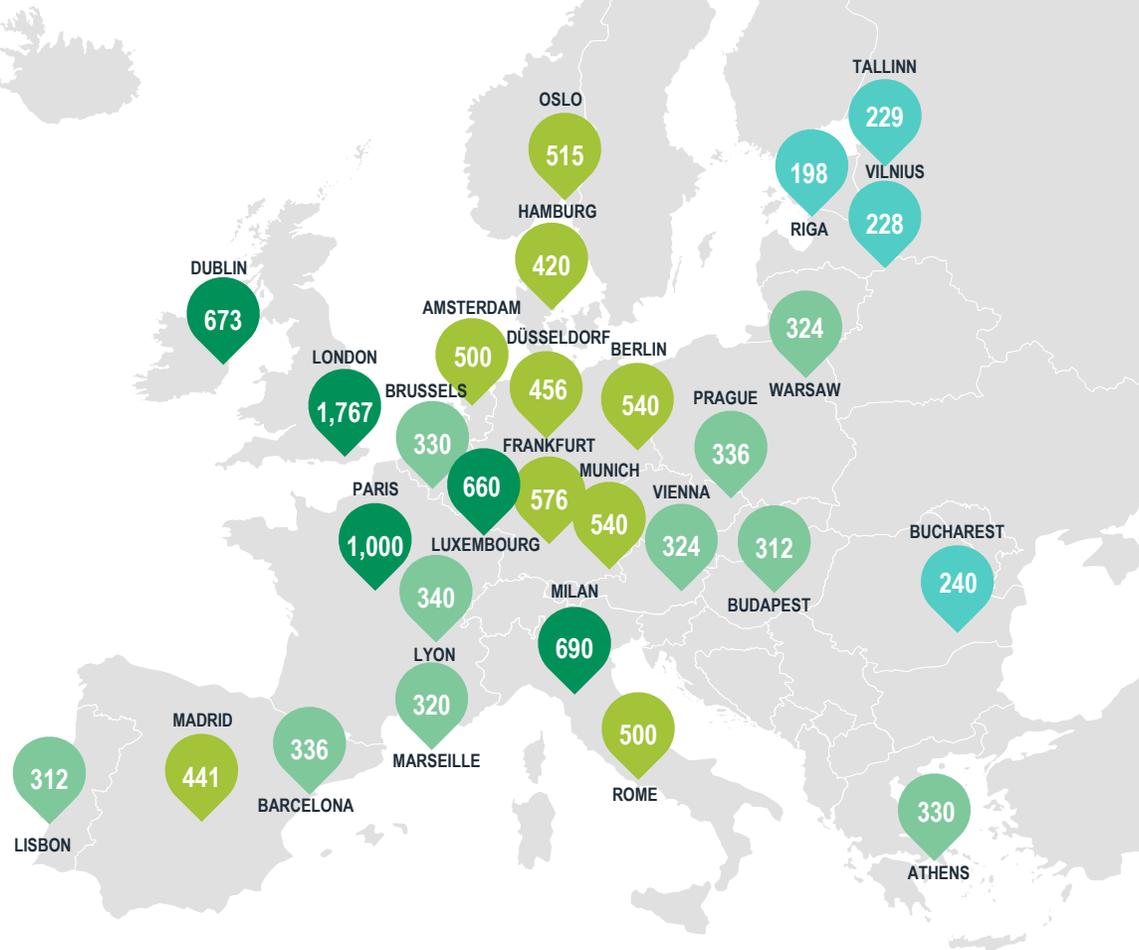


Vacancy remains under control in Europe

- The overall vacancy rate in Europe stood at 7.5% at Q1 2023 (+20bp vs. Q1 2022).
- Most markets are stable, though vacancy increase occurred in Barcelona (+300 bps vs. Q1 2022) and Dublin (+210 bps) which saw strong completions in 2022.
- Most markets are seeing two-speed dynamics, with low availability in central submarkets and in new buildings, and much higher vacancy rates in peripheral office districts.

OFFICE PRIME RENTS IN EUROPE

Q1 2023 vs Q1 2022



Rents are in €/sqm/year

- > €600
- € 300 - 400
- € 400 - 600
- < € 300

Source: BNP Paribas Real Estate

Prime rents still driven by the demand for quality

- Having sustained value over the crisis period, prime office rents in the key cities are now growing again.
- With the widespread uptake of hybrid work models, companies are seeking attractive and modular workplaces offering greater connectivity.
- The very low availability of prime assets and the appeal of high quality buildings located in the most sought-after districts drive values up.
- Over the past 12 months, London (+21%), Milan (+10%), Warsaw (+8%), and Dublin (+8%) have seen the most significant increases in values.

LOCATIONS

EUROPE

FRANCE

Headquarters
50, cours de l'Île Seguin - CS 50280
92650 Boulogne-Billancourt cedex
Tel.: +33 1 55 65 20 04

GERMANY

Goetheplatz 4
60311 Frankfurt am Main
Tel.: +49 69 29 89 90

UNITED KINGDOM

5 Aldermanbury Square
London EC2V 7BP
Tel.: +44 20 7338 4000

BELGIUM

Avenue Louise 235
1050 Brussels
Tel.: +32 2 290 59 59

SPAIN

C/ Emilio Vargas, 4
28043 Madrid
Tel.: +34 91 454 96 00

IRELAND

57 Adelaide Road,
Dublin 2
Tel.: +353 1 66 11 233

ITALY

Piazza Lina Bo Bardi, 3
20124 Milano
Tel.: +39 02 58 33 141

LUXEMBOURG

Kronos building
10, rue Edward-Steichen
2540 Luxembourg
Tel.: +352 34 94 84

Investment Management
Tel.: +352 26 06 06

NETHERLANDS

Antonio Vivaldistraat 54
1083 HP Amsterdam
Tel.: +31 20 305 97 20

POLAND

Grzybowska 78,
00-844 Warsaw
Tel.: +48 22 653 44 00

PORTUGAL

Avenida da República, 90 Piso 1,
Fracção 1
1600-206 Lisboa
Tel.: +35 1 939 911 125

MIDDLE EAST / ASIA

DUBAI

Emaar Square
Building n° 1, 7th Floor
P.O. Box 7233, Dubai
Tel.: +971 44 248 277

HONG KONG, SAR CHINA

63/F, Two International
Finance Centre
8 Finance Street, Central,
Hong Kong, SAR China
Tel.: +852 2909 8888

SINGAPORE

20 Collyer Quay, #17-04
Singapore 049319
Tel.: +65 681 982 82

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