Tariffs and European Real Estate: A First Reaction

April 2025

IN A NUTSHELL

- We currently see few reasons to expect a price correction in European real estate. Despite a possible modest downgrade to our rental outlook, market conditions are robust.
- Five-year swap rates have fallen in response to a potential reduction in inflation, and the possibility that European central banks could cut interest rates further than expected, supporting real estate pricing.
- We're seeing evidence of capital considering increasing allocations in favour of Europe. Core European real estate may be the most obvious beneficiary, but we also see positives for some higher-risk Living strategies.

No pricing correction

We do not expect the ongoing trade war to lead to a correction in European real estate values. Given the backdrop this may seem like an anxiety-inducing statement, but as things stand today, European real estate conditions are robust, and in some ways could even benefit. This is not to say we see no impact. And while we continue to believe that 2025 could be an exceptional vintage, with a likely downgrade to the rental outlook, as well as a period of investor caution, the immediate backdrop looks less certain.

But we should remember what was driving our positive outlook. The occupier market is in good health, with industrial vacancy rates at 5-6%, and residential at just 3%.[1] While a slowdown in economic growth may moderate rental progression, the European economic downgrade is relatively modest, and over the medium term far less impactful than the proposed fiscal stimulus from the new German government.[2] Add to this, uncertainty holding back development, and what was already destined to be a period of limited new supply could become one of acute shortages, again supporting rents.

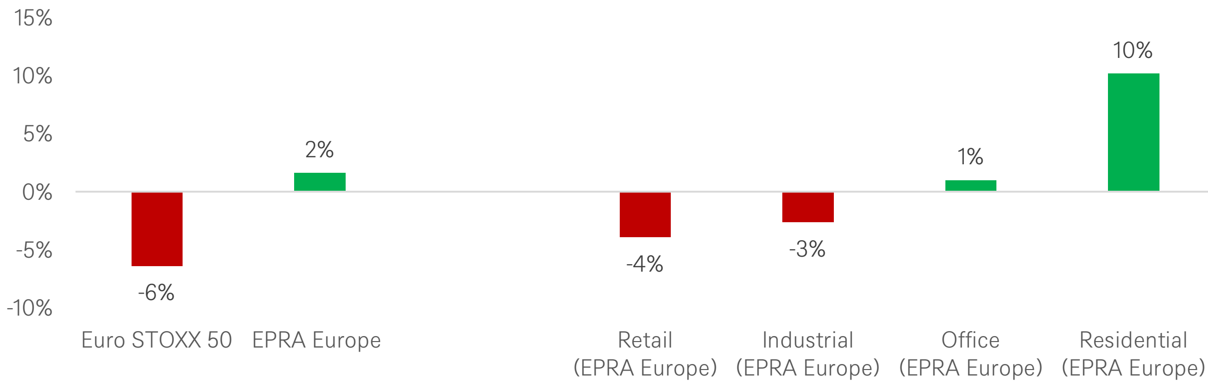
Fundraising and transactions have been well below history, and if investors react to these events with a pause, yield compression may moderate. However, we're not yet seeing evidence of this, with retail money potentially being encouraged

[1] PMA, Broker sources, April 2025
[2] Oxford Economics, DWS, April 2025

back to real estate. We need to remember that real estate is coming from a cyclical low, and when considered in context, real estate looks attractively priced relative to other asset classes. For some, uncertainty may even present opportunities to acquire assets in a less competitive environment, particularly if it encourages more risk averse asset owners to sell.

Despite the volatility in equity markets, we see few reasons to suggest that real estate pricing should be materially lower. Down 13% in the aftermath, by 16 April the Euro Stoxx 50 had regained half of what had been lost, while REIT markets, more resilient during the initial phases, were trading at 2% above peak, with some European Residential names posting significant positive appreciation over this period – in part driven by a corresponding fall in borrowing costs.[3] By mid-month, five-year Euro swap rates were 25 basis points below their March peak, and while we have seen some widening in credit spreads, early indications are that lending margins on real estate have remained broadly unchanged.[4]

Total Shareholder Returns Since "Liberation Day" (2-April 2025 to 16-April 2025)



Source: EURO STOXX 50 Index and FTSE EPRA/NAREIT Developed Europe Index, Macrobond as of 16 April 2025

European real estate upsides

Looking beyond this period of volatility, we should also consider the implications for inflation. While retaliatory tariffs by the EU could put upwards pressure on prices, as of today, lower global growth, falling oil prices, a weaker dollar, and overcapacity in China all point towards disinflation, opening the possibility that European central banks could be able to cut interest rates, further supporting real estate pricing. Taking this one step further, given areas of spare capacity across parts of the construction industry – German construction capacity utilisation rate has fallen to near 60%, below Global Financial Crisis levels[5] – it's not implausible that development cost inflation could moderate and enhance the profitability of development and other value-add projects.

Anecdotally we're seeing capital increasing allocations in favour of Europe over the US. Given the recent relative strength of fundraising for US focused products ($66 billion versus $20 billion in 2024) this looks to be an opportunity for Europe. And while cross-border capital has historically been a relatively small part of the US transactions market – circa 10% over the past decade – at €23 billion in 2024 if partially re-allocated, this could positively influence European liquidity.[6]

Time to dig into the detail

The impact will be felt differently depending upon city, sector and risk profile. Today it's difficult to provide full clarity, and it will take a few more weeks to run new forecasts. But for now, we can try to draw some early conclusions. Our overweight calls on Germany, Amsterdam, Madrid and Milan, and a focus on supply constrained locations look well supported, while

[3] Macrobond, April 2025
[4] Macrobond, April 2025
[5] Bloomberg, March 2025
[6] Preqin, MSCI, April 2025

positive calls on Dublin and Warsaw may prove premature. London and Paris, currently sitting with neutral calls, may attract risk averse capital, while London's financial services sector could gain at the expense of New York. Our living sector conviction has only strengthened, but we could expect a downgrade to some logistics markets. Given pro-cyclical demand, we remain cautious on peripheral office, although central locations in major cities could be more resilient. And finally, the events of 2 April have created uncertainty and risk, again stressing the importance of real estate fundamentals, lease lengths, and tenant credit.

It would be wrong to conclude that the European real estate market will benefit from the events of 2 April, as trade frictions and financial market volatility weigh on rental growth and liquidity. But it does remind us of European real estate's attractive features, and why the sector could be a relative winner and a place of stability in a volatile world. Core real estate may be the most obvious beneficiary, but we also see positives for the higher risk strategies, particularly in the living sectors, where low vacancy, less development, and even construction cost disinflation combines to form a potentially compelling strategic investment opportunity.

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