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THE APPEAL OF EUROPEAN NET LEASE TO NON-EUROPEAN INVESTORS

The global uncertainty created by U.S. tariff policy has unsettled financial markets and has cast a shadow on economic growth prospects. While the situation remains fluid with many moving parts, we believe that a corner of stability may be found in European commercial real estate, which has significantly repriced since market peaks in 2022, and where market fundamentals remain solid and macro-drivers broadly supportive. Defensive, income-oriented strategies – such as European Net Lease – can be especially interesting for non-European investors seeking stability, yield, and geographic diversification. This report sets out the rationale for that conviction.

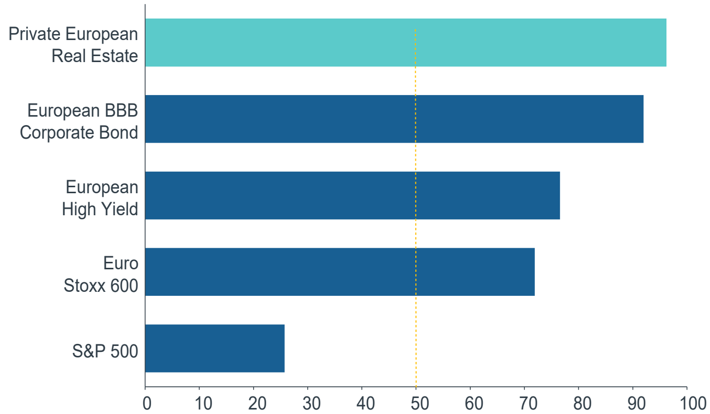
WHY EUROPE? ATTRACTIVELY PRICED AND FUNDAMENTALLY SOUND

Since mid-2022, private European commercial real estate (CRE) has experienced a significant repricing. Capital values have recently stabilised, and total quarterly returns have been positive over the past year *(Figure 1)*, suggesting a potentially attractive entry point into the next cycle. Importantly, the delta between appraisal and market cap rates in Europe is minimal relative to the U.S.[1] Moreover, European CRE currently compares favourably to other asset classes that have already recovered in value more rapidly *(Figure 2)*. Finally, while developed CRE markets have historically shown high correlation, the diversification benefits offered by European CRE *(Figure 3)* are likely to become increasingly attractive amid shifting globalisation dynamics and growing policy divergence.

FIGURE 1: INREV FUND-LEVEL RETURN

Source: INREV, Clarion Partners Global Research, Q4 2024.

FIGURE 2: RELATIVE VALUATIONS OVER 10-YEAR PRIOR



Source: Bloomberg, Green Street, Clarion Partners Global Research, Q1 2025. Note: Graph shows normalised Z scores of following valuation metrics: Private European Real Estate: prime yield; European BBB bonds: yield-to-convention; European HY bonds: yield-to-maturity, REITs: implied economic cap rate, unweighted average of office, retail and industrial; S&P 500 and Eurostoxx 600: P/E Ratio. The asset classes are associated with different levels of volatility, liquidity and other risks.

FIGURE 3: CORRELATION ANALYSIS (Q1 2005 - Q4 2024)

ASSET TYPE	INREV ALL FUND
NFI-ODCE	0.76
S&P 500 Index	0.23
Euro Stoxx 600	0.27
European Aggregate Bond Index	-0.25
Bloomberg U.S. Aggregate Bond Index	-0.25

Source: INREV, NCREIF, Bloomberg, Clarion Partners Global Research, May 2025.

Despite global uncertainties, Europe's macroeconomic environment is broadly positive. Inflation in the Eurozone has moderated and is now hovering around the European Central Bank's (ECB) 2% target. This creates potential for a more accommodative interest rate and monetary policy stance, which should act as a tailwind for CRE valuations and transaction activity. Market fundamentals remain generally robust across sectors, with vacancy rates relatively low in key sectors, such as logistics, which have seen a relatively less pronounced development cycle (compared to the U.S. markets, for example).

Key reasons we believe Europe is relatively attractively priced:

THEME	EUROPE	U.S.	NARRATIVE
Spreads	🟢	🟡	**European real estate generally offers a healthy positive spread over the cost of debt.** For example, the cap rate for B/B+ quality European logistics assets stands at approximately 6%, compared to cost of debt of 3.50%–4.00%. In contrast, in the U.S., nominal cap rates average around 5.2%, while typical borrowing costs exceed 6%.[1] This is particularly relevant for income-focussed strategies and a good barometer of relative value.
Asset repricing and expected growth	🟢	🟢	**Asset values in Europe have repriced more significantly, potentially offering greater upside.** Green Street's industrial CPPI declined by an average of 23% from peak to trough, compared to a 17% decline in the equivalent U.S. index.
Interest rate risk	🟢	🟡	**Europe's more benign inflation outlook supports a more accommodative interest rate policy.** In contrast, policy uncertainty–particularly around tariffs–is driving higher inflation expectations in the U.S. Bloomberg consensus inflation forecasts for 2025 rose by 70 basis points to 3.2% between December 2024 and April 2025, well above the Federal Reserve's target. As a result, markets have been pricing in a slower pace of rate cuts in the U.S.[2]
Fundamentals–supply	🟢	🟢	**Most European property sectors also report lower vacancy rates than their U.S. counterparts.** For instance, logistics vacancy in the EU stood at 5.2%, around 100 basis points below the U.S. market. That said, U.S. logistics experienced strong rental growth during the pandemic, which is expected to support net operating income (NOI) growth to a greater extent going forward.

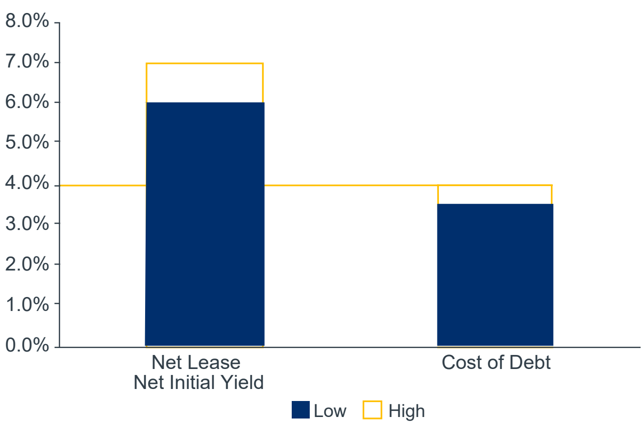
[1] Industrial/logistics cap rates as reported by Green Street as of Q1 2025.
[2] As of May 19, 2025 markets were pricing in an 8.5% chance of a 25 basis points rate cut at the Fed's upcoming June meeting (down from 60% a month earlier) and a 29% chance of a cut at the July meeting (down from 84%). Source: Bloomberg.

WHY EUROPEAN NET LEASE?

Within the broader European CRE landscape, we believe that Net Lease strategies warrant serious consideration. At this stage in the cycle, their appeal lies in a defensive profile – where returns are driven primarily by secured contractual income and lease indexation – rather than relying on less certain assumptions around market rent growth or exit yields. Historically, European Net Lease has outperformed broader market benchmarks during periods of macroeconomic uncertainty, as investors have placed a premium on long-duration, stable cash flows.[2] Furthermore, we see four key advantages of European Net Lease – particularly when compared to equivalent U.S. strategies:

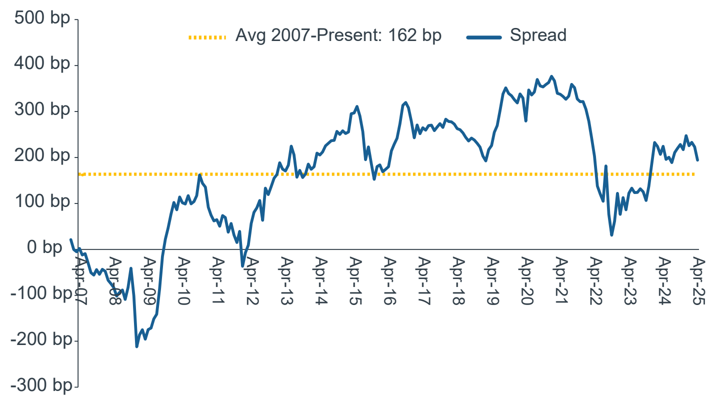
Attractive Day 1 Yield Spread: Following interest rate repricing, European Net Lease now offers an appealing Day One yield spread over the cost of debt *(Figure 4)*. This compares favourably to the U.S., where it is not uncommon for new acquisitions to be cashflow-negative in early years due to higher debt costs. More broadly, European CRE also seems to trade at a relatively attractive spread to fixed-income alternatives in historical context *(Figure 5)*.

FIGURE 4: TYPICAL RANGE OF EUROPEAN NET LEASE NET INITIAL YIELD VS. COST OF DEBT



Source: Clarion Partners Global Research, May 2025. Note: yield range reflects transactions underwritten by CPE.

FIGURE 5: EUROPEAN CRE CAP RATE SPREAD VS. INVESTMENT GRADE



Source: Green Street, Clarion Partners Global Research, May 2025.

Inflation Linked-Cashflows: A significant differentiator specifically for European real estate as compared to U.S. is the indexation of rental income to inflation, either capped or uncapped. This feature provides a built-in hedge against inflation and contributes to capital value preservation through indexed growth. By contrast, U.S. leases more commonly include fixed uplifts that may lag behind actual inflation. Over the last five years (2020–2024), European Net Lease income grew on average by 4.5% per annum, versus just 0.1% in the U.S.[3]

Market Inefficiency Premium: European Net Lease – proxied by corporate disposals – has averaged over €20bn per annum in transactions over the last 10 years.[4] We think the addressable market is vast given relatively high ownership rates in Europe (~65%).[5] While expanding, the European Net Lease market remains relatively opaque, with many transactions occurring off-market via direct negotiation or corporate finance routes. Although this can pose a barrier to entry, it also creates opportunities for specialist managers with strong local networks to exploit inefficiencies, uncover hidden value, and generate robust risk-adjusted returns.

Limited Capital Competition: A corollary of the previous point is the relatively limited capital competition in the European Net Lease market. One indicator of this is the number of specialist REITs operating in the space – just three in Europe[6] compared to 17 in the U.S.[7] – as well as their comparatively short trading histories. Many Net Lease/long-income investors are UK-based and typically target a core return profile. There is generally a lack of pan-European platforms pursuing higher-yield strategies. This capital demand-supply imbalance is a compelling feature of the European Net Lease market which allows investors to lock in potentially attractive yields on acquisition.

CONCLUSIONS

European Net Lease presents a compelling investment case for global investors seeking secure, inflation-resilient income in today's fragmented and shifting macroeconomic landscape. With favourable yield spreads, structurally sound fundamentals, and inflation-linked rental streams, the strategy combines downside protection with long-term upside potential. While European Net Lease market complexity requires specialist expertise, it also creates inefficiencies from which well-positioned investors can benefit. In a world of growing divergence, European Net Lease offers a strong risk-adjusted investment opportunity for global real estate capital allocation.

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[1] Source: Stepstone Real Estate House Views, Spring 2025 Report.
[2] Findings based on TTM Total Return of MSCI UK Long-Income OEPF Index relative to UK All Balanced OEPF Index between December 12 and September 24.
[3] Source: Green Street. Note: Green Street reports l-f-l Net Rental Income growth for Europe and Same Store NOI growth for the U.S.
[4] Source: Raising Capital from Corporate Real Estate, JLL, April 2025.
[5] Source: Clarion Partners Global Research's estimates based on EPRA. As of April 2025.
[6] Source: Green Street had three net lease REITS under its European coverage as of February 2025.
[7] Source: Hoya Capital. As of May 2025.

INDEX DEFINITIONS

The **NFI-ODCE** is a capitalization-weighted, gross of fee, time-weighted return index.
The **S&P 500 Index** is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the United States. Indexes are unmanaged and one cannot invest directly in an index.
The **STOXX® Europe 600 (Euro Stoxx 600)** is a broad measure of the European equity market. With a fixed number of 600 components, the index provides extensive and diversified coverage across 17 countries and 11 industries within Europe's developed economies, representing nearly 90% of the underlying investable market.
The **Bloomberg Euro Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, euro denominated, fixed-rate bond market, including treasuries, government-related, corporate and securitized issues.
The **Bloomberg US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar denominated, fixed-rate taxable bond market.

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International investments are subject to special risks including currency fluctuations, social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets.**
Commodities and **currencies** contain heightened risk that include market, political, regulatory and natural conditions and may not be suitable for all investors.
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