

Market Intelligence

# Market Outlook 2023

REPORT

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Luxembourg  
REAL ESTATE

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# A tumultuous 2022 allows market players to regroup for new opportunities in 2023

## A PARTICULARLY CHALLENGING YEAR

Rising inflation, energy threats and interest rates resulting from the war in Ukraine challenged the Luxembourgish economy and real estate markets in 2022. The rapid changes to financing costs negatively impacted the commercial real estate investment market, with total volume notably down from recent years. Still, most investors are positioned to ride out the volatility until price stability returns. Office occupier markets were also subdued on account of the market uncertainty, but the lack of EU activity and limited available space were also obstacles. Retail markets continued on their post-Covid high for a banner year, even seeing rental growth. Sharply-priced residential markets met the reality of rising interest rates, with sales slowing and prices under threat in the second half of the year.

## LUXEMBOURG RESILIENT TO CHALLENGES OF 2023

While these macro changes weighed on Luxembourg's economy in 2022 with subpar GDP growth below the wider EU average, the Grand Duchy is well-placed to weather a difficult 2023. Tripartite negotiations and complementary measures including increased wage indexation and an energy price shield should support households' purchasing power and business confidence. And despite recession fears, STATEC forecasts positive economic growth of 1.5% in 2023 (as of December 5th, 2022). The European Commission is even more optimistic, with expectations of a 1.7% expansion in 2023 and 2.4% in 2024 (as of February 13th, 2023). Inflation began cooling notably in November and is forecast to continue that trend through 2023 to a more manageable 3.4% in 2023<sup>1</sup>. Luxembourg's resilience is best captured in its labour market. Unemployment was just 4.8% in 2022 with a slight bump to 5.1% expected in 2023 amidst a record high of job vacancies<sup>1</sup>.

## REASONS FOR OPTIMISM

In 2023, real estate markets should emerge from this period of uncertainty. No major changes in investment market dynamics are expected until the second half of 2023. Occupiers are demanding ESG space, with an equal enthusiasm coming from the ongoing office project developments. Retail demand will continue to be stable in 2023 thanks to strong socio-economic fundamentals. Residential is expected to see a decrease of activity, with sales declining and commercialization times lengthening, though the case for more diversity in housing options, such as coliving, will strengthen.

<sup>1</sup>STATEC

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CRE investment in Luxembourg retreated to just €1.0 billion in 2022, as owners were in no rush to sell at new, repriced market conditions. We do not expect major changes in market dynamics before Q3 2023. Retail investment is slightly regaining interest, though high residential prices are preventing multifamily sales.

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Frictions are developing in the market that will hinder activity in the coming year beyond the well-documented persistent lack of available of quality space. Occupiers are demanding ESG-compliant space, but the market has been slow to respond. Occupancy costs are rising, and those that can kick the can down the road are likely to do so until more market certainty returns.

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## RETAIL

Core Luxembourg retail markets have solidified and will continue to experience stable demand in 2023 despite the expected broader slump. Vacancy is virtually non-existent in the best locations, and recent activity suggests some secondary markets are becoming more attractive to retailers. New international retailers are interested in entering the market, but real estate supply constraints are obstacles.

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## RESIDENTIAL

Eye-watering apartment prices are meeting the reality of rapidly increasing interest rates. Continued price appreciation in already expensive markets thus looks unlikely, as a recalibration of yields will stabilize prices as rents continue to rise. Overlevered developers are in a precarious financial position, with asking price reductions likely. Investors will look to the north for more attractive investment opportunities.

01

# Investment

## OUTLOOK

CRE investment in Luxembourg retreated to just €1.0 billion in 2022, as owners were in no rush to sell at new, repriced market conditions. We do not expect major changes in market dynamics before Q3 2023. Retail investment is slightly regaining interest, though high residential prices are preventing multifamily sales.

### INVESTMENT CONTEXT

The CRE investment market had a fairly slow 2022, with a total volume of €1 billion euros. Limited activity in mid-cap transactions was the difference maker compared to recent years. 2023 is also forecast to be moderate given the macro environment. High inflation has driven central banks to increase interest rates, driving yields higher as assets are repriced accordingly. The extent to which yields increase is heavily dependent on central bank activity. They are likely to be under upward pressure for much of 2023.

€1.0 bn

2022 CRE investment volume in Luxembourg, declining by one-third, y-o-y

### AN OWNER'S MARKET

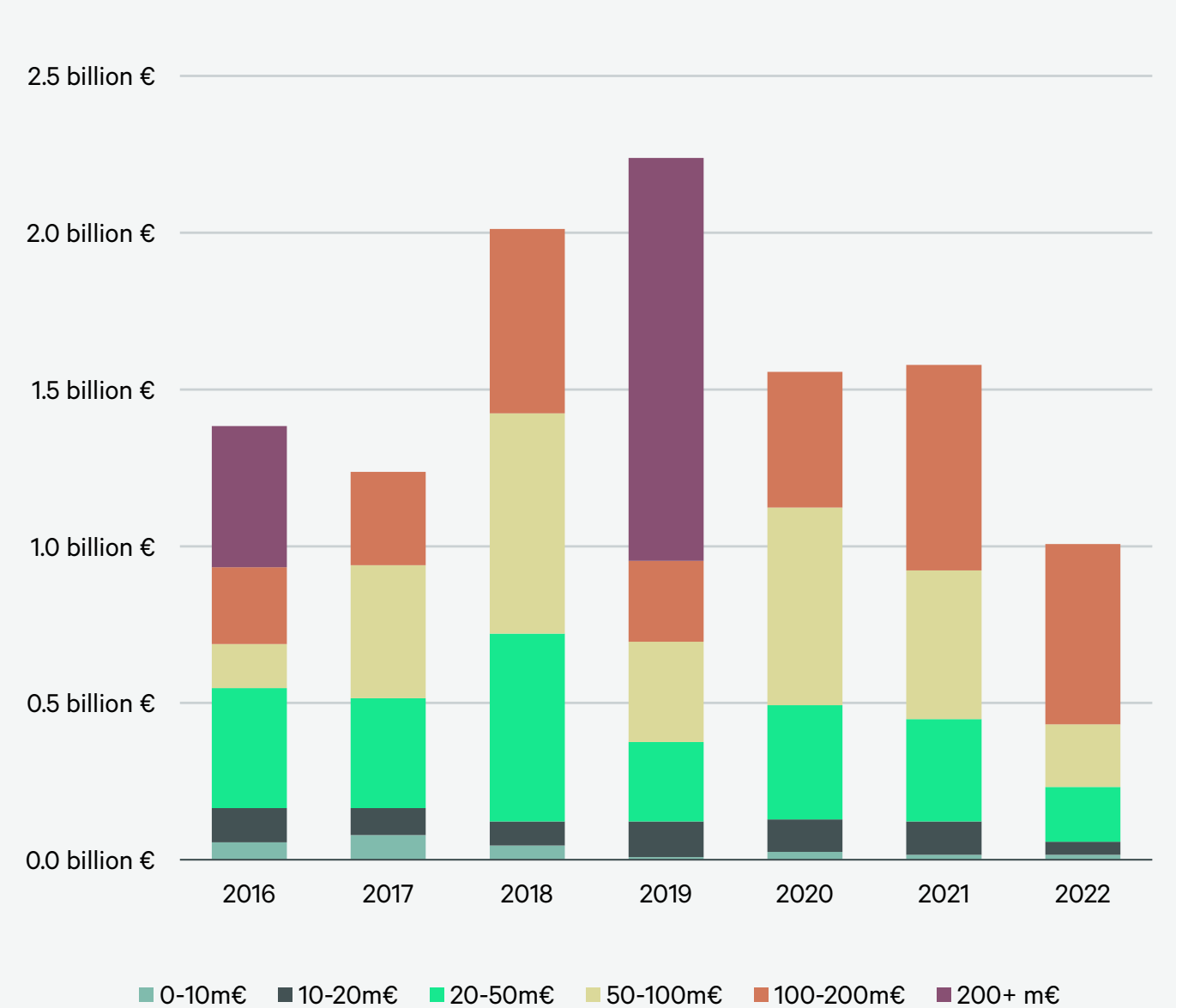
The attractiveness and fundamentals of the Luxembourg market remain positive. Luxembourg has experienced rapid and robust population and economic growth and is forecast to continue to do over the long-term. These forces favor owners.

In the short term, increasing yields as a result of interest rate pressures and low and stable vacancy are driving owners to be patient. Those with manageable debt loads are happy to collect steady income streams and do not need to accept a haircut from a spike in yields. Developers and investors with burdensome debt loads may be forced to sell if refinancing becomes too much of an obstacle. More aggressive investors may be seeking to raise capital to seize on opportunities if and when they arise. Full equity investor's are the preferred buyers, as bank financing has become more expensive and more difficult to secure.

Owners are also flexing their muscles through the slower adoption of ESG principles despite the increasing demand from investors and occupiers. Core institutional investors require compliance with EU taxonomy, quality tenants following ESG strategies, green leases and market-recognized certifications such as BREEAM Excellent and EPC A scores. New development is just now implementing the latest performance and high-efficient technologies which will hit the market in the next two years. Banks are now one of the biggest drivers of ESG as they are increasing requirements for financing.

Luxembourg CRE investment by deal size

Source: CBRE





Campus PWC by Atenor, Cloche d'Or

### MOBILITY SOLUTION(S) NEEDED

Outside of the macro environment, mobility continues to be a problem, particularly after more than two years of homeworking. The development of new transport infrastructure has not kept pace with the demand for its use. And while the tram is facilitating movement within the city, an increasing population and frontier worker base is finding it difficult to get to the city in the first place. This is a pain point that needs a solution.

# 4.00%

Prime yield for centrally-located office assets in Luxembourg as of February 2023

### ASSET CLASSES

Offices will continue to be the dominant asset class in 2023. But, due to the lack of transactions and polarization of the office stock between Grey and Green buildings, market pricing will remain challenging.

Investors are weighing a return to retail real estate. Fundamentals are strong and rents are nearing their cyclical highs. Top locations across all formats have few availabilities. Residential transactions will be limited, as assets undergo repricing from very sharp yields. Residential real estate with an operator such as coliving will be the most reasonable entrance to this market for new investors, but these assets are few and far between. Though not as well-developed as the office and retail markets, industrial and logistics assets will continue to garner interest. A tight occupier market will weather a moderate economic decline well.

02

# Offices

## OUTLOOK

Frictions are developing in the market that will hinder activity in the coming year beyond the well-documented persistent lack of available of quality space. Occupiers are demanding ESG-compliant space, but the market has been slow to respond. Occupancy costs are rising, and those that can kick the can down the road are likely to do so until more market certainty returns.

### LUXEMBOURG OFFICE OVERVIEW

Office take-up was down in 2022 by 44% year-over-year to 207,000 m<sup>2</sup>. The large deals that typically drive the market failed to materialise during the year from disruptions and retooling of occupier strategies. That said, the breadth and diversity of deals was on trend with recent years, with the lack of available space a persistent obstacle. Demand for quality office space is certainly present in the Duchy's growing market, though 2023 may well be another challenging year given these and macro constraints. Those who can kick the can down the road may opt to do so.

### TAKE-UP DECOUPLING FROM DEMAND

While take-up is the traditional barometer for demand in the market, recent dynamics have seen a divergence between the two. With vacancy of less than 4%, supply constraints are restricting take-up in the face of good demand. Additionally, occupiers are increasingly requiring high quality spaces fulfilling ESG standards that the market is struggling to meet. The latest designs, materials and techniques are needed to control increasing occupancy costs and meet both governmental and corporate performance goals. Well-designed spaces also play an important role in bringing people back into the workplace and attracting/keeping talented staff. There is, therefore, a reliance on the new, high-quality projects to meet this requirement.

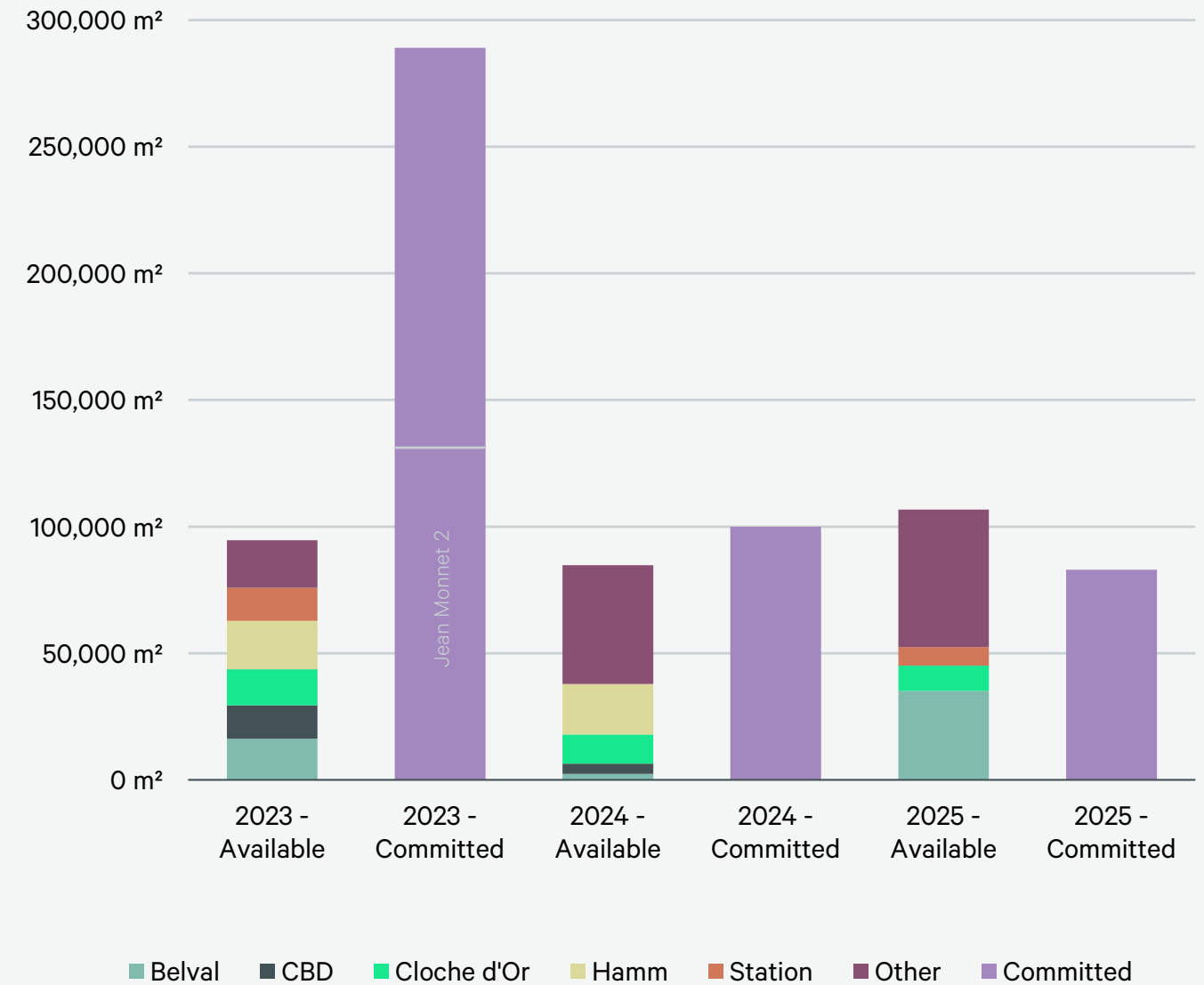
There is little room for occupier movement at the moment. The projected pipeline for 2023 is 383,000 sqm of new projects - of which 95,000 m<sup>2</sup> is still available - so opportunity to meet spatial demands remains limited. For the projects that are delivered, demand will follow this supply. Esch-belval, CBD, Cloche d'Or, and Station will be the biggest beneficiaries. Kirchberg is conspicuously absent from this list.

95,000 m<sup>2</sup>

Available pipeline for 2023 in the entire Luxembourg market

Luxembourg office pipeline by markets with notable speculative space

Source: CBRE





Royal Park by Baltisse, CBD

### THE CITY CENTRE REIGNS

Demand for space is strongest in Luxembourg City. Central districts (CBD, Station, Kirchberg) are often operating at less than 2% vacancy while experiencing strong demand. The successful commercialization of Royal Park is evidence of that. The services and amenities offered there are a major attraction when it comes to location decisions. Still, this must be balanced with accessibility. The city centre may offer the most appeal, but those who do not need to be there and/or those with a large proportion of frontier workers may be better served by the growing peripheral markets. The large available pipeline in Esch-Belval (53,000 m<sup>2</sup> in 2023 to 2025), for example, may offer more appropriate opportunities.

## 54 €/m<sup>2</sup>

Monthly Luxembourg office prime rent

### RISING COSTS SHAPING THE MARKET

Rising costs are a threat on several fronts. General occupancy costs for tenants are increasing - notably energy - but also other costs such as parking that can push 450 €/spot/month in central districts. Construction costs are also impacting the development pipeline. As at the end of 2022, the construction index is up 16% year-over-year. Speculative development now requires a substantial proportion of pre-commitment from tenants for proper risk management and securing financing. This is also up from the last 12 to 24 months and could have implications for the longer-term pipeline when only certain occupiers can make such commitments.

**Rising costs and financing requirements will make it more difficult to bring fresh, modern space to market**

04

# Retail

## OUTLOOK

Core Luxembourg retail markets have solidified and will continue to experience stable demand in 2023 despite the expected broader slump. Vacancy is virtually non-existent in the best locations, and recent activity suggests some secondary markets are becoming more attractive to retailers. New international retailers are interested in entering the market, but real estate supply constraints are obstacles.

### RETAIL OVERVIEW

Retail surprised this year with better-than-expected results. Rents are returning to previous cyclical highs not seen for several years, and vacancy is low to non-existent for top high streets, shopping centres and out-of-town locations. The pipeline of demands for 2023 is in line with pre-Covid years. Despite short-term concerns, retailers understand the long-term fundamentals that make Luxembourg retail an attractive market.

62k m<sup>2</sup>

Luxembourg retail take-up in 2022 supported by both high streets and out-of-town

### SECTORS ON THE MOVE

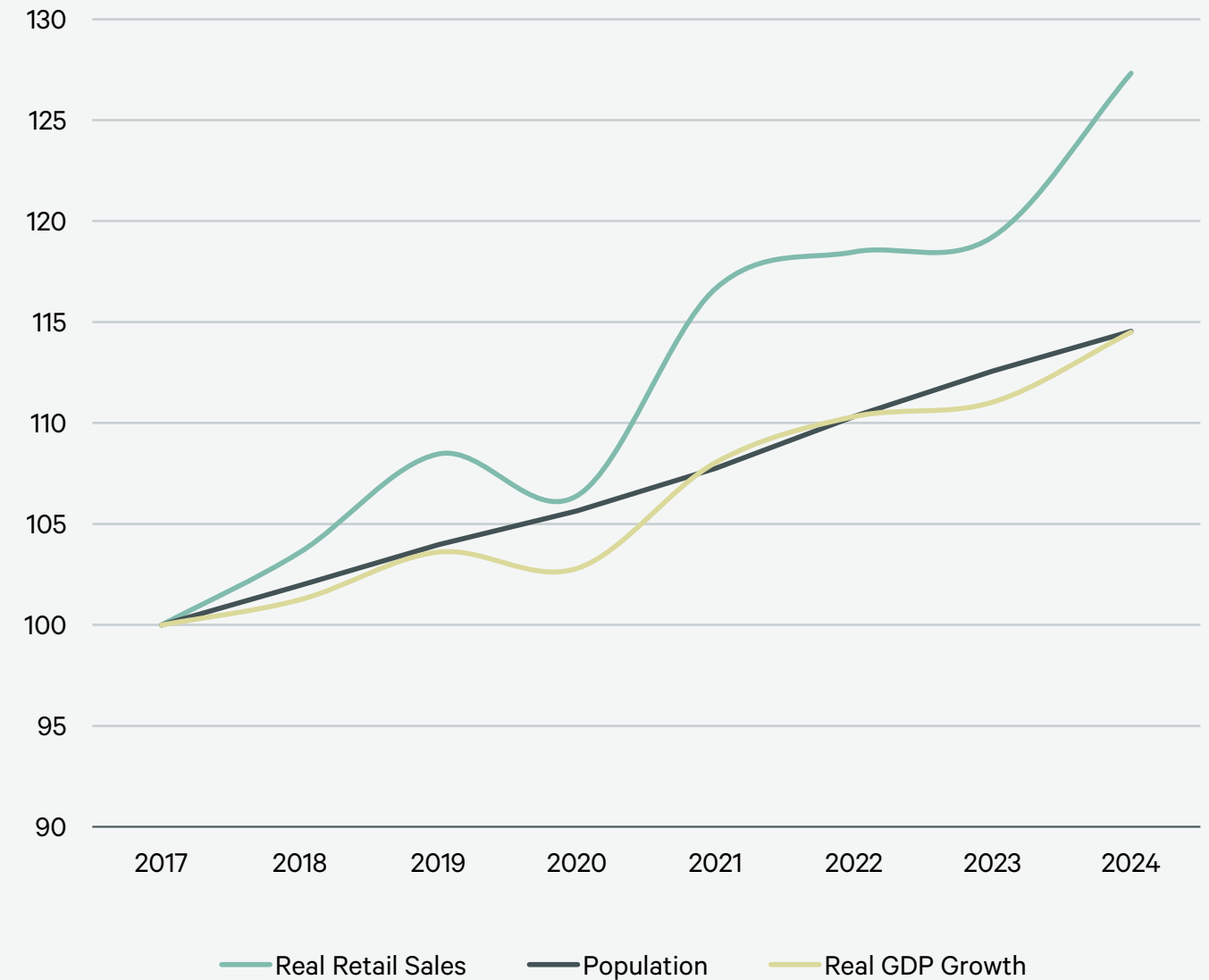
Sectors expected to carry their momentum into 2023 include luxury, sports and sneakers, discounters, food and beverage, and home and household. Luxury watches continue to make inroads in markets, with famous brands adopting ambitious global expansion plans. One notable sports retailer is searching for more than 1,000 sqm following the success of related retailers such as Footlocker. Low cost retailers have increased market share in recent years and look to continue to do so. The pandemic-fuelled expansion of food and beverage and home and household retailers looks to carry forward this year as well.

### POTENTIAL FOR GROWTH

Despite the massive expansion of retail space since 2017, new retailers are finding it difficult to enter Luxembourg on account of the lack of available quality space. French retailers, for example, accustomed to robust out-of-town offers in their domestic market are finding it underdeveloped in Luxembourg. Developing new space is challenging, meaning the market is unlikely to solve spatial constraints in the short to medium term. As a result, retail asset values are well supported.

Indexed macro Luxembourg metrics (2017=100)

Source: Oxford Economics & CBRE





Courir, Knauf Schmiede

### OPPORTUNITIES ARISING

Secondary locations that have experienced significant repricing since 2018 have become attractive to the right retailers. Locations such as Avenue de la Gare in the Station district are ripe for a change of fortune.

The Royal Hamilius on Boulevard Royal is another example. Five new retailers secured space here in 2022, with food and beverage retailers leading the charge, and strong interest is emerging from fashion retailers. The striking project is headed towards full occupancy more than three years after its completion.

2,000 €/m<sup>2</sup>

Annual prime high street retail rent in Luxembourg CBD

AAA locations are experiencing rising rents and near zero vacancy in what could be a turning point for retail

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# Residential

## OUTLOOK

Eye-watering apartment prices are meeting the reality of rapidly increasing interest rates. Continued price appreciation in already expensive markets thus looks unlikely, as a recalibration of yields will stabilize prices as rents continue to rise. Overlevered developers are in a precarious financial position, with asking price reductions likely. Investors will look to the north for more attractive investment opportunities.

### RESIDENTIAL OVERVIEW

Residential prices hit new highs in 2022, following the long-standing trend. That said, the landscape is being complicated from macro developments, though recent changes are not fully captured in the latest figures. Sales are declining and commercialisation times are lengthening, as rising interest rates, high prices and an uncertain outlook bite.

Average purchase prices for the Grand Duchy increased 5.1% from 2021 to Q3 2022 (latest available data) to €695,385 (8,933 €/m<sup>2</sup>)<sup>1</sup>. The increase is most apparent in existing apartments (+6.6%) versus new builds (+5.5%). While solid growth figures, they represent a notable slowdown from the previous two years, with Q4 activity unlikely to drive these meaningfully higher.

### PRICES STABLE FOR NOW

Luxembourg possesses excellent long-term fundamentals for a strong residential market. In the short term, however, prices will slow and stabilize, allowing rents to rebalance with stretched prices.

Currently, prices are highest in Luxembourg City, recording 10,352 €/m<sup>2</sup> for second-hand and 12,643 €/m<sup>2</sup> for new builds in Q3 2022. Bertrange is similarly priced at 10,363 €/m<sup>2</sup> and 12,373 €/m<sup>2</sup>, respectively. Strassen, Walferdange and Hesperange are also among the top-priced markets, but remain under the 10,000 €/m<sup>2</sup> mark for second-hand apartments, on average.

In terms of rents, Leudelange is the sole locale averaging apartment rents greater than 40 €/m<sup>2</sup>/month (43.35 €/m<sup>2</sup>/month), followed by Mondercange (38.12 €/m<sup>2</sup>/month), Luxembourg City (36.80 €/m<sup>2</sup>/month), Sandweiler (35.83 €/m<sup>2</sup>/month), and Esch (34.14 €/m<sup>2</sup>/month). As apartment sizes differ across the Duchy, tenants' monthly payments are highest in Sandweiler (1,891 €/month), Bissen (1,883 €/month), Niederanven (1,871 €/month), and Contern (1,825 €/month). Average rents in Luxembourg City are 1,539 €/month given their smaller footprints.

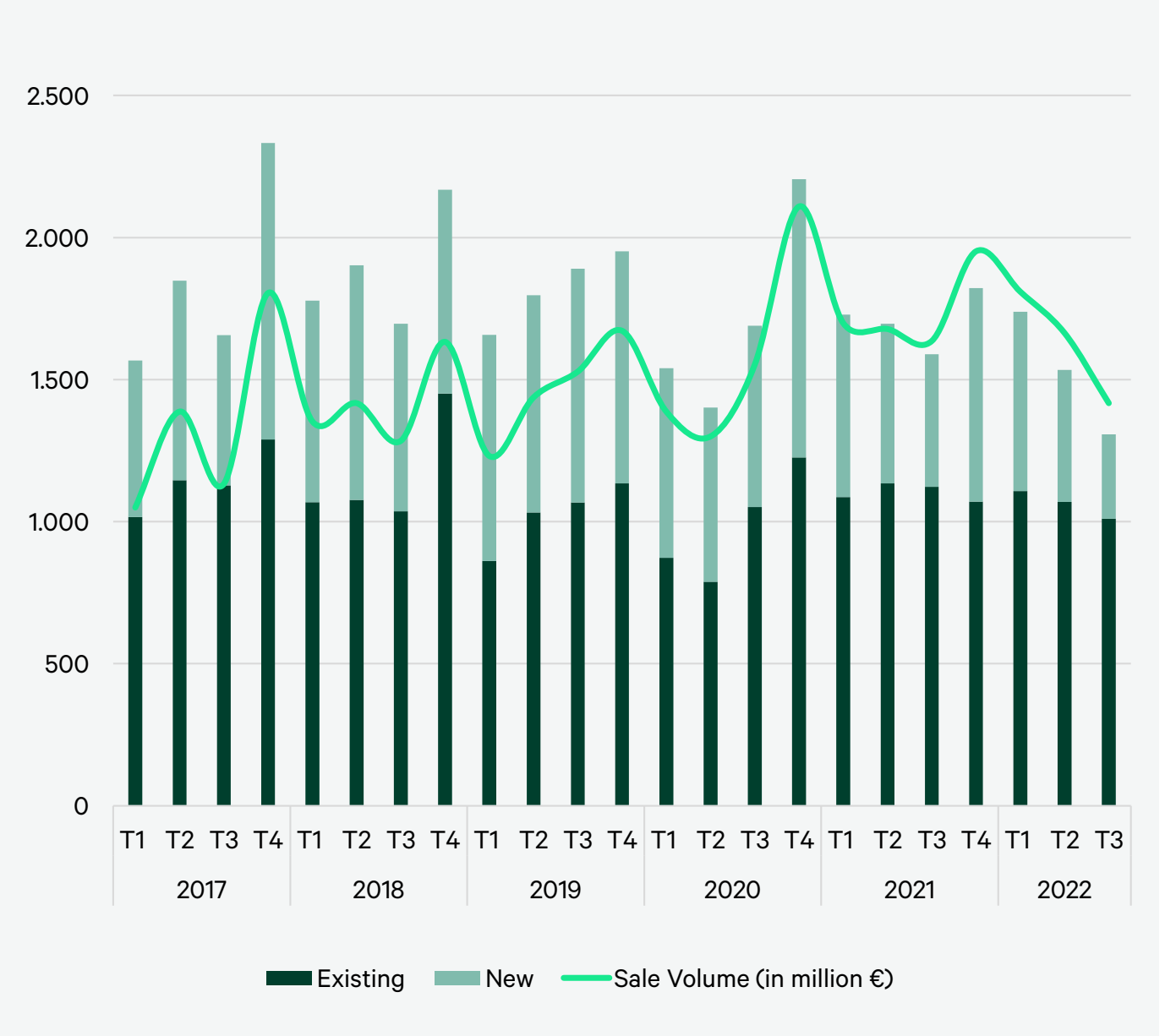
With southern and central locations sharply priced, well-connected towns in the north can offer more attractive opportunities for tenants and buyers alike.

€695,385

Average apartment sale price in Luxembourg in Q3 2022

Number of residential transactions (columns) and total volume (line)

Source: STATEC



<sup>1</sup>STATEC



### **SALES SLOWING**

The evolution for 2023 is beginning to unfold. The quantity of apartment sales has decreased, suggesting the deceleration of price growth is likely to continue. Quarterly (Q3 2022) apartment sales are down 26% from the five-year average, originating almost entirely in the new-build market. The rapid macro changes have left some developers in a delicate financial situation, which may well lead to lower asking prices.

### **RENTING LOOKS ROSIER**

The rental market is expected to be supported from increasing financing costs and general economic outlook. And given the shortage of quality apartments available for rent, rental prices may well be under upward pressure.

This will also be supportive of the coliving market. Coliving can offer residential options in sought-after locations for a lower absolute cost compared to traditional apartments. In an economically tumultuous year where people are more price sensitive, quality coliving options should experience high demand. New, institutionally-backed operators like Colonies and Cohabs are making inroads in the market, but it will be H2 2023 or 2024 before new projects are fully operational.

**Stretched apartment prices are likely to rebalance with rents in 2023, as interest rates drive an increase in yields**

# Contacts

## CBRE Office

### Luxembourg

12C Impasse Drosbach  
1882 Luxembourg  
+352 26 26 12

## Office Lead

### Frank Rosenbaum

Managing Director  
+352 621 310 300  
frank.rosenbaum@cbre.com

## Capital Markets

### Jérôme Coppée

Director  
Capital Markets  
+32 2 643 73 75  
jerome.coppee@cbre.com

## Office & Retail

### Virginie Chambon

Director  
Head of Investor Leasing  
+352 621 473 927  
virginie.chambon@cbre.com

## Occupier Services

### Michael Taelman

Senior Director  
Head of Occupier Services  
+32 2 643 33 14  
michael.taelman@cbre.com

### Dylan Feber

Senior Consultant  
+352 621 694 568  
dylan.feber@cbre.com

## Valuation

### Pieter Paepen

Senior Director  
Head of Valuation Services  
+32 2 643 32 26  
pieter.paepen@cbre.com

## Research

### Kim Verdonck

Senior Director  
Head of Research & Marketing  
+32 2 643 33 34  
kim.verdonck@cbre.com

### Drew Misner

Senior Research Analyst  
+32 2 643 33 66  
drew.misner@cbre.com

### Joanne Wrobel

Marketing & Research Manager  
Luxembourg  
+352 26 26 12 33  
joanne.wrobel@cbre.com

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