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Market in Minutes
Where should core and value-add investors look across Europe?

October 2018

Investment activity maintains a high volume

According to our preliminary estimation, the commercial investment volume during Q3 reached approximately €57.5bn. This is -3% compared to the same quarter last year which reached a record high and 8% above the 5-year average. This would bring the total volume since the beginning of the year to approximately €160bn.

Based on our Q1-Q3 preliminary figures we expect Greece, Portugal, Poland and Ireland to stand out showing strong annual increases (of approximately 80%). The share of core markets is likely to account for 67% of the total investment volume in Europe, in line with the same period last year (66%).

Real estate still looks very good

Real estate remains an asset class of choice. The spread between the average 10y bond yield and the prime office yield is at 248bps (Q2 18), which compares to 180bps in 2008 and a 10-year average of 237bps. Hence, the amount of capital targeted at the real estate market remains significant. In strong markets, the number of underbidders for large deals exceeding €500m generally ranges between three and five. For smaller investments (<€100m), it generally ranges between 10 and 15. Some markets have also witnessed an increasing number of off-market deals, revealing sellers' confidence in finding the right offer.

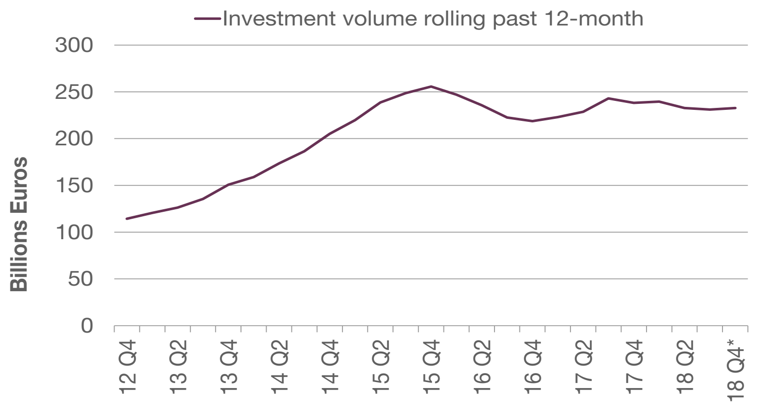
"Short-haul" overtaking "long-haul" capital inflows

Overall, the share of foreign capital remained unchanged over the past five years, accounting for more or less, half of the total volume invested in commercial properties. However, since the beginning of the year, cross-border inflows mainly came from European countries. According to RCA data, during the first half of the year, European capital (domestic and cross-border) accounted for 77% of the total investment volume, compared to 67% during the second half of 2017 and 71% on average over the past five years. British, German, French, Swiss and Swedish are amongst the most active European investors in the Europe property market.

On the global investors' stage, investments from the US are slowly decreasing. US investors seem to be struggling with finding the right properties as they tend to progressively cycle out of opportunistic strategies to focus into core/ core plus opportunities. Yet, in volume, they remain by far the most active cross-border player on the European property market. The decrease of Asian inflows is mainly due to the Chinese government's restriction to outbound investments, whilst interest from Korean investors is strengthening and from Singapore investors is continuing. The return from Middle-East investors is also firming.

FIGURE 1

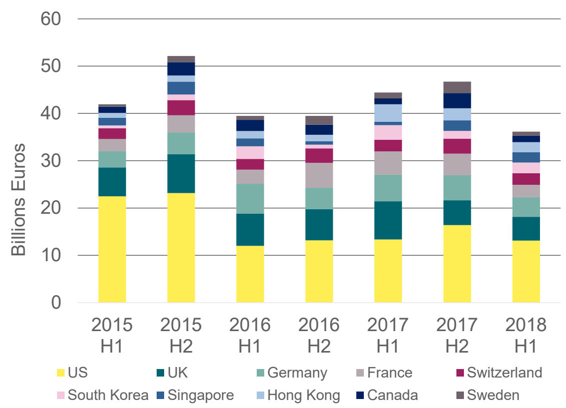
Investment activity Normalisation towards €200bn to €250bn annually



Source: Savills

FIGURE 2

Major cross-border investors Chinese investors disappeared from the European scene



Source: RCA

They are generally yield-hungry and target opportunities mainly in the UK, Germany, the Netherlands, Spain and Italy across sectors.

Office assets are on a roll

Offices remain the preferred asset class accounting for 45% of all investments, from 44% last year. The property fundamentals of the sector look bright. Thanks to improving labour market and solid business expansion, office vacancy rates hit record lows in all major European cities, hence pushing rents up. Last year, the average annual prime rental growth reached 6% on average across the European cities we survey, with London WE (13.9%), Stockholm (12.5%), Berlin (12.4%) and Madrid (10.7%) at the top of the league.

Due to the tight supply situation in CBD markets, secondary locations are becoming increasingly popular as long as they are well-connected. Availability of land is also often better than in central districts. Forward funding a high-end speculative project in these areas is looking increasingly attractive to investors as shown by the rising number of such deals.

Prime yield compression easing

In nearly half of the European cities we cover, prime CBD office yields remained unchanged compared to last year. In Q2 2018 the average European prime CBD office yield was at 3.84%. This is -14bps yoy compared to the same period last year and -2bps compared to last quarter showing signs of stabilisation. Due to office stock shortages and premium pricing, prime non-CBD office yields remain under downward pressure. On average across Europe, it moved in by 31bps. The average prime Non-CBD office yield currently stands at 4.9%.

Prime shopping centre yields stabilised at 4.5% on average, whilst prime high street yields hardened by 13bps, with the European average at 3.4%.

Logistics and retail warehouse yields converging

As a result of growing online sales, investor interest in logistics and retail warehousing is increasing thus putting downward pressure on yields. Prime logistics and prime retail warehouse yields experienced the highest compression of all sectors, -45bps and -37pbs year-on-year. The European averages are currently at 5.4% and 5.3% respectively.

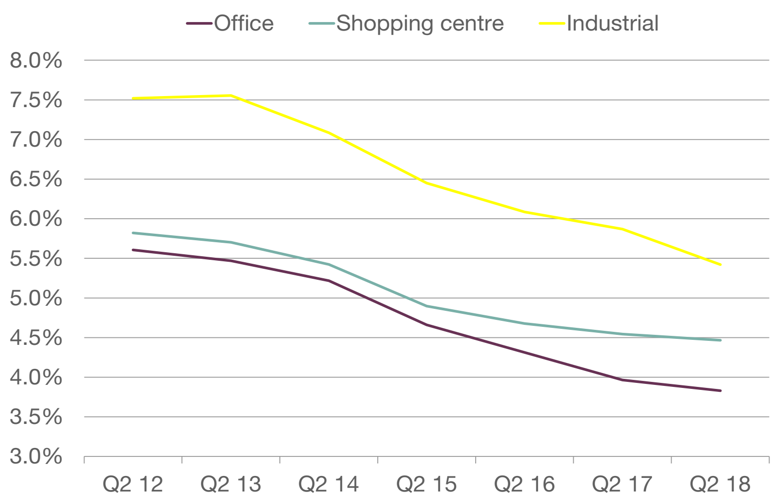
OUTLOOK

Still enjoying a tailwind climate

- In 2018, the European Commission forecasts GDP to grow by 2.1% annually in both the Eurozone and the EU28, which remains solid by historic standards.
- On the political landscape, difficult negotiations to reduce trade barriers, to find a Brexit-deal and Italy's fiscal clash are looming over the future prospects of the European economy.
- Yet, another year of low-interest rate environment will continue to attract capital into the European real estate market.
- We expect the investment volume to reach approximately €232.5bn at year-end, compared with €238.2bn last year.
- Investors interest in prime income-generating assets will strengthen. Offices will remain the preferred sector but premium pricing on such scarce assets class will encourage investors to look further afield in niche sectors.
- As the prime European property market is becoming pricy and the global stage unstable, overseas commitments are likely to slow down. This will provide more opportunities to European property investors to develop their activities in neighbouring countries.

FIGURE 3

Prime yields Compression is slowly easing except for logistics assets

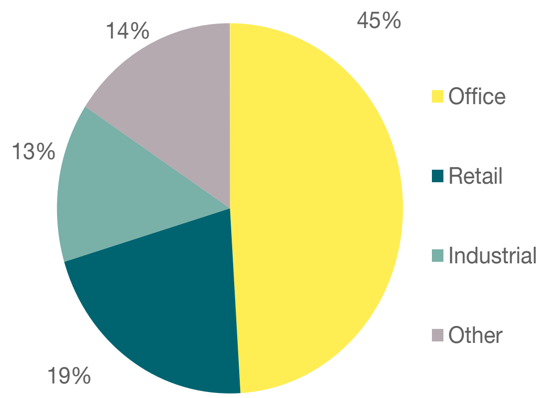


Source: Savills

FIGURE 4

Volume breakdown per asset type

Office sector dominates



Source: Savills

WHERE SHOULD CORE AND VALUE-ADD INVESTORS LOOK ACROSS EUROPE?

Offices, offices and offices

Overall, core and value-add investors should look at offices, office developments and office refurbishments. This is unsurprising given the liquidity and transparency of this asset class. It is also currently the less disrupted sector of all commercial asset classes. The very nature of the last economic crisis has slowed down, if not stopped, development activity for financial reasons, leading most core European markets into strong undersupplied situations when the recovery came. The sector is currently boosted by business expansion, employment growth and a significant need for modern premises which, was restrained during the crisis.

Beyond the limelight…some interesting niche markets

Due to the nature of sthe economy of some coutries, its political focus or demographics changes, other asset classES including hospitality, private rented sector (PRS), student housing or care homeS in some specific markets, can offer investors with great opportunities.
Overall rising trade volumes and expanding e-commerce are driving demand for logistics space and quality schemes are becoming scarce in most European countries, which put upward pressure on rents.
In the UK the retail segment is undergoing strong repricing, which will soon bring to the fore some prime opportunities for good value. Retail sale and lease-back acquisitions is an alternative way to source property, notably in Spain and Italy as long as the retail tenant is showing "future-proof" strategy and their properties are in prime locations.

Country	Core	Value-add
Austria	**Prime private rented sector (PRS) Vienna** Vienna accounts for a fifth of Austria's population. It is a densely populated city that attracts a lot of immigrants. Nearly a third of residents are classified as foreign-born. Between 2007 and 2017 the city's population has grown by 12%, amongst the fastest in Europe and is forecasted to maintain its position until 2025. Unsurprisingly, demand for residential units is strong while there is a strong shortage of residential properties in Vienna and the development pipeline is limited. This is notably a magnet for German investors who have a large appetite for this asset class.	**PRS & retail regional cities** In regional cities with high purchasing power and strong touristic inflows such as Graz, Linz or Salzburg both residential and retail properties offer good opportunities attracting European investors but mainly Germans. These cities traditionally offer a yield premium currently at approximately 25-50bps.
Belgium	**Brussels prime CBD offices** Brussels is a major geopolitical city, which hosts many European institutions and international organisations such as The European Parliament and NATO. Hence, public services are the most dominant sector of the local economy, accounting for over a third of jobs. This explains the overall stability of the country, notably its relative resilience to economic downturn compared to most other European countries. By 2020, corporate tax will fall to 25% (from 29.58%), which should attract more companies to locate in Brussels. Additionally, numerous developments currently under construction or recently delivered, provide the investment market with new opportunities.	**Office refurbishments in Brussels** The lack of core and core+ assets available on the market and the very high prices of such products have pushed investors towards the "office refurbishment" option. The CBD office vacancy rate is forecast to reach 4.1% by the end of the year. Yet, the BrusselS office stock still counts numerous premises built in the 1970's or refurbished in the late 1990's early 2000 that need to be refurbished to be marketable.
Czech R.	**Prague CBD offices** In 2017, the employment rate in the Czech Republic has reached an all-time low (2.9%). This is the lowest unemployment rate in Europe and it is set to maintain this rank over the next five years. At the same time, the number of job vacancies hit a high in June this year, reflecting the current strong business expansion environment. Strong office demand has squeezed the level of supply and put upward pressure on rental levels. The vacancy rate is likely to reach 6.5% at year-end from 7.5% at the end of 2017.	**Non-core office refurbishments in Prague** GDP growth is expected to reach 3.9% in Prague in 2018, notably bolstered by strong service sector performance. This means that Prague is forecasted to feature amongst the top five fastest growing cities. Strong economic fundamentals combined with very low labour cost is attracting international companies looking to offshore. However, the level of office supply is low and there is a crucial need for modern office space.

Country	Core	Value-add
Denmark	**Central offices in Copenhagen** Over the last two years, numerous companies have taken the leap towards larger facilities, which have prompted more bustle in the letting market. The companies often seek presentable and larger lease space, better locations with good infrastructure.	**Care homes** Care homes are a serious matter in Denmark, even said to be the one area of consensus in parliament. In fact, Denmark is one of the best places in the world to grow old, together with Sweden and the Netherlands. Danish citizens are the highest-taxed in the European Union, of which, approximately 50% is spent on welfare. The care home property market is self-regulated by local municipalities and the market is rather transparent as social care data was digitalised back in 1995. The rapid ageing population is anticipated to create substantial demand for care homes in the coming decades.
France	**Prime offices in the Paris region** The Parisian letting market is buoyant and set to remain flourishing for the next two years. Office demand is fuelled by business expansion led by improving economy, strengthening labour market and an overall more positive political backdrop. The vacancy rates in the Paris region and most particularly in the CBD have reached a record low since 2001, which in turn put upward pressure on rents. Additionally, the Paris region benefits from the large "Greater Paris" infrastructure project and the perspective of the 2024 Olympic Games, which fuel future development in the French capital.	**Office development in the suburbs of Paris** The "Greater Paris" urban plan is offering new lively areas, which will be well connected to all the main transport hubs and which are away from the dense traffic congestion of the city centre. These new areas offer great opportunities for office development at a time when modern office space is so much in need.
Germany	**Offices in the top seven cities** All of the top six office lettings markets are characterised by massive supply shortages. The vacancy rate in Berlin (1.6% Q2 2018) is the lowest of all European cities. Hence, rents have reached record highs. A significant volume of office space is scheduled to come to the market in 2019-2020, although nearly half of it is already pre-let. This should slightly reduce the pace of rental growth and at the same time provide the investment market with new opportunities.	**Development land** With supply having been unable to keep pace with the growth in demand in most sectors, vacant properties are now a rarity in many major cities. Development land has become a key solution for value-add investors seeking office, residential or logistics buildings in strategic areas.
Greece	**Prime offices in Athens** For now, Greece is not the best-performing country in Europe but in 2019 GDP is expected to grow by 2.3% and by 2.4% on average between 2018 and 2022, well above the European average. The labour market is also recovering, employment in Athens is expected to grow by 1.8% in 2018, the second highest growth behind Madrid. The office vacancy remains relatively high compared to other cities but most of the vacant supply is old. Demand for new and modern office buildings is growing and puts upward pressure on prime rents, which is likely to continue for the next years to come.	**Hospitality** Tourism is the star of the Greek economy. Even during the recent crisis, the tourism industry has been one of the mainstays of economic growth and employment. Tourist numbers have increased by an additional two million every year for the past three years. No major European destination has seen a bigger increase in visitor numbers this decade. In 2017, tourist traffic increased by 9.7%, reaching 27,194 million visitors and 32 million visitors are expected this year. The hotel industry is performing well with a high level of occupancy and a strong REVPAR (revenue per room).
Ireland	**Prime private rented sector (PRS) Dublin** Ireland's strong economic expansion has led to quite a rapid population growth. Although housing output is now picking-up strongly it lags some way behind demand. Consequently, residential vacancy rates have been pushed down to very low levels and prices and rents are rising strongly. Average rents rose by 8.8% in Dublin over the year to June 2018 and are forecast to increase further over the next three years.	**Retail warehousing** Housebuilding activity rose by 46% y/y in 2017 and by a further 31% in H1 2018. Given the depth of housing demand this dynamic will remain in play over the coming 3-5 years at least. The decoration and fit-out of newly constructed homes, along with rising house prices, which encourages investment in the existing housing stock has driven strong sales growth in big-box format stores including Electrical goods (+18.5% y/y in July), Furniture (+10.3%) and Hardware (+3.8%). Given the nature of the goods that are traded in retail warehouses, the sector is also more protected from online competition than some other retail formats. Particularly in suburban locations with strong housing development pipelines, retail warehousing could outperform.

Country	Core	Value-add
Italy	**Prime Milan offices & Prime high street in touristic areas** Although GDP growth in Milan will lag behind its European city peers, employment growth will be on a par thanks to business services that provide the main impetus. Between 2018 and 2022 office-based employment in Milan is forecasted to grow by 1.6% annually on average (1% in the EU and 1.3% city average). The CBD office occupational market is solid with a decreasing level of vacancy. Income per head in Milan is high, 30% above the national average and around 18% above the European city average. Milan's reputation as a global centre notably supports the tourism economy. Italy is the fifth worldwide tourist destination. The number of tourist visits to Milan will increase at a steady rate over the next five years while Rome will remain one of the most popular destinations in Europe, especially for overseas visitors.	**Milan offices & Prime high street refurbishments** The lack of prime office and prime high street space available on the market and the strong yield compression that undergone such assets over the past five years has led investors to consider refurbishment as an alternative option.
Luxembourg	**Prime offices in new locations** The office vacancy in Luxembourg and in particular in central districts has reached historical lows (below 1% in CBD and Kirchberg) and prime rents are pushed up further. Occupier demand far exceeds supply and around 70% of the future office supply until 2020 is already pre-let or is intended for owner occupation. Office districts in close proximity to the central districts benefit from this situation. The upside potential of the rental levels and the tramway project, which will be finalized until 2021 are important criteria which increase the attractiveness of alternative office locations. Additionally, recent corporate tax cuts from 21% to 18% enhance the competitiveness of the country.	**Speculative office developments** GDP growth in Luxembourg is forecasted to be close to 4.0% in 2018 and outpace the major European cities until 2020. The country's strong economic fundamentals combined with the shortage of office supply provides investors with the opportunity to position themselves for speculative developments, which offers a value-add factor.
Netherlands	**Prime & Non-prime offices in Amsterdam** Amsterdam benefits from a concentration of high value-added industries, which makes the Dutch capital a popular place to work. As 90% of the Dutch population speak English, the city is an attractive destination for foreign talent. More than one in four residents are foreign-born. In this post-Brexit negotiation period, it provides Amsterdam with strong advantages, which have already attracted large companies including, Panasonic, Ferrovial, and the European Medecine Agency (EMA). Office-based employment is set to grow by 1.4% on average between 2018 and 2022. The office leasing market is buoyant, with notably low vacancy rate (5.8%) and significant rental growth (5.1%).	**Student housing** Amsterdam is a young and cosmopolitan city which offers great universities and many English spoken courses. Fees are relatively low compared to other major European cities and the level of student housing supply is good both in terms of quantity and quality. Hence, Amsterdam is a popular place to study. Over the past 15 years, the number of students has increased by over 40% to approximately 692,000 enrolments in the current academic year. Of this number, 49% live away from home. This has led to a surge in the demand for student accommodation.
Norway	**Central offices & Hospitality in Oslo** The unemployment rate in Norway is one of the five lowest across Europe and employment growth is set to remain strong over the next five years compared to other European countries. Office demand in central locations is robust and it is expected to continue, reaching a histric low vacancy rate of 5.2 %. In the short term, the supply side is low, and in the medium term it is expected to remain fairly modest. Over the past nine years, the number of international tourist arrivals in Norway has been increasing constantly. Demand is increasing in all three categories; business, conference and leisure. Market supply is fairly moderate and is not projected to upset occupancy rates going forward. Hence, hotels performances (Sold rooms, ADR and RevPar) are rising and reached historic levels in Olso.	**Fringe offices & High street retail in Oslo** As central office locations are becoming full, we expect to see an increasing demand for offices in fringe areas and therefore more rental growth in these locations. Older buildings or available plots close to public transport hubs in fringe clusters are ripe for development. High end prime high street retail is still fairly new in Oslo, which provides room for further consolidation and development of older properties with low standards.

Country	Core	Value-add
Poland	**Prime offices in the three main cities & Logisitics** The polish economy will be one of the fastest growing over the next five years and by 2022, the unemployment rate is forecasted to be become one of the lowest across Europe (behind the Czech R.). In Warsaw, office-employment based is set to expand by 1.8% annually on average between 2018 and 2022. Trade, transport and storage is by far the largest sector of the Warsaw economy, which can be explained notably by the strategic location of the country between the western and eastern part of Europe. The logistics sector is showing strong performances including record high take-up, well-balanced level of modern supply and strong rental growth prospect. The yield gap with mature western European countries is an additional advantage to attract investors.	**Office refurbishment & Retail in key cities** Forecasted strong employment growth and decreasing level of supply leave some space for office development or refurbishment of the old stock especially since the demand fuelled by the ICT sector concentrate on new and modern office spaces. Over the next three years, retail sales in Poland will be the fastest growing in Europe after Ireland. Since the retail stock per inhabitant is relatively low compared to other European countries there is a need for small retail parks and convenient shopping centres in new and fast growing residential areas.
Portugal	**Offices in Lisbon** In 2018, the Portuguese entered its fifth consecutive year of growth, with still positive forecasts for the coming years. This favourable landscape is reflected in increased office demand; the level of take-up has been growing since 2014. Since most of the development activity was put on hold during the crisis, the office vacancy rate is shrinking, which put upward pressure on rents. In addition, Portugal has been chosen by many companies to install their shared-service centres due to the strategic location, highly qualified human resources, a competitive labour market and fiscal advantages among other reasons. Hence, shared-service centres represent a significant market share in the office take-up.	**Office developments in Lisbon and Porto** The existing supply and the office pipeline planned for the near future is not keeping up with the rapid growth of demand. The existing pipeline mainly refers to the refurbishment of existing office buildings, verifying a shortage of new buildings to meet the current demand for new and modern space.
Romania	**Logistics** In recent years, the Romania logistics market expanded rapidly notably thanks to the entrance of new industrial market players from both the development and investor sides. Romania is home to the second largest population of the CEE countries after Poland and its citizens have good level of education and strong languages skills, whilst the wage level is lower than in other European countries. Demand for logistics property is high and vacancy rate is very low (around 2% in Bucharest and 5% nationwide). New modern facilities recently delivered on the market provide investors with great opportunities at competitive prices compared to other European countries.	**Bucharest residential & Land development** The population in Bucharest is the first largest in CEE countries and the sixth largest in Europe which explains notably the urban sprawl over the surrounding rural areas of Bucharest. Very few residential units have been developed between 2008 and 2015. Improved financing conditions coupled with rising salaries have led to increasing demand for quality dwellings. The M6 metro project is creating opportunities for new residential hubs where plots of land are available and suitable for residential devolvement. Overall the Romanian property market is still quite underdeveloped compared to other European cities. Plots of land are available, building consent is relatively flexible and as the economy is growing rapidly, there is a need for specialist retail units in secondary cities and modern logistics facilities across the country.
Spain	**Prime CBD offices & Prime high street in key cities** Spain is forecasted to be one of the fastest economies of the Eurozone in 2018 (2.8% GDP). The labour market is improving. Over the next five years, employment is forecasted to grow annually by an average of 1.7% and 1.5% in Madrid and Barcelona respectively, well above the European average. Job gains in business services (notably ICT in Madrid) are likely to provide a strong impetus for office-based employment. The structural changes in the retail sector push retailers with visionary strategies, to heavily invest in technology or logistics. Retail ownership (notably high street) is still often in hands of retailers, one way to unlock some capital is to sale and lease-back.	**Office developments & Office refurbishments** Strong office demand for modern office space backed by fast-improving labour market, notably from the ICT sector, coupled with low vacancy rates and ageing stock is pushing is invetors towards refurbishments and new developments.

Country	Core	Value-add
Sweden	**CBD Offices in major cities** The Stockholm office market has one of the lowest vacancy rates in European after Berlin hence putting upward pressure on rents. Rental growth is expected to continue as the development pipeline remains insufficient to meet the demand. Solid rental growth is also expected in Gothenburg and Malmo which are also relatively under-supplied.	**Retail parks** The Nordics and notably Sweden have one of the highest shopping centre stock per inhabitants across Europe. The same is not true for retail parks, although Sweden is home to the famous worldwide big-box retailer, IKEA. However, the popularity of this retail format is strengthening as rents are much lower than in shopping centres and generally quite stable. Prime retail park yields are high compared to other asset classes. Population growth, strong urbanisation in major cities and above European average retail sales expected for the next five years add up on the demand side.
UK	**Logistics & London offices** In spite of relatively low economic growth prospects compared to other European markets, the UK property market remains the most mature of all, with generally long leases, highly liquid and transparent. London is proving quite resilient to the Brexit uncertainty and remains the most innovative city in Europe with the highest tech-related venture capital funding. The high and rising ecommerce share in Europe is fuelling demand for logistics properties both regional and urban.	**Office development & Retail** Some 55% of the UK office pipeline is already pre-let and the number of development starts is expected to decrease despite the strong take-up. Retail assets, regardless of quality, are being impacted by the current sentiment in the sector as a whole, notably through a strong repricing. We expect some prime retail assets will be good value soon.

Please contact us for further information

Marcus Lemli
European Investment
+49 69 273 000 11
mlemli@savills.de

Lydia Brissy
European Research
+33 (0) 1 44 51 73 88
lbrissy@savills.com