Briefing note
Themes for European property in 2017

February 2017

Brexit, Trump, Renzi and more to come in 2017

If one thinks 2016 was a bumpy year on the political scene, 2017 may prove to be equally staggering. Following the "Yes" vote for Brexit, Trump's victory in the US election and Renzi's resignation after landslide referendum defeat, shockwaves will continue to reverberate throughout 2017 although economic impacts are yet hard to quantify.

The main threat hanging over the future of the already fragile Europe is an "exit" epidemic, especially since elections in Germany, France, the Netherlands, and most probably Italy will open a large window of "opportunities". First symptoms of a hard Brexit though, may well lead voters to think twice.

Interest rates vs prime property yields

Although long term interest rates are expected to rise to 1.16% on average in the Eurozone (against 0.91% last year), the property market will still stand out high on investors' radar compared to other assets types, due to the attractive spreads above bond yields (graph 1). We expect some further hardening of property yields in 2017, of approximatly 60bps on average across sectors and across Europe. We anticipate the 2017 investment volume in Europe to be relatively similar to that of last year, around €200bn.

Look at non-CBD locations

Since investors are in competition for the same assets in the same locations, opportunities are tailing away, which in turn puts upward pressure on prices. Therefore investors are likely to broaden their scope in terms of geography towards secondary locations where available prime assets can be more easily found, competition is less fierce and yields are higher.
At the same time, property fundamentals of non-CBD locations are also looking good. In core countries notably, office supply has reached pretty much the same low as pre-crisis levels and the situation is becoming critical for companies who need to relocate. Several are now forced to move out to suburban locations which offer newly developed large-scale office premises. This explains why we expect prime rental growth to be stronger in non-CBDs.

Forward funding speculative projects

In core markets where prime products are becoming scarce in both the occupier and investor markets forward funding a speculative project is increasingly attractive. The office pipeline planned for 2017 suggests a rebound of 25% of development activity, most of which has been already pre-let. This will offer both tenants and investors some new opportunities.

Since the availability of land is often limited in downtown locations, these projects will mainly grow in peripheral areas. Investors should focus on cities where vacancy rates are very low (including London, Paris, Stockholm, London and Zurich).

Logistics will be "near-shoring" city centres

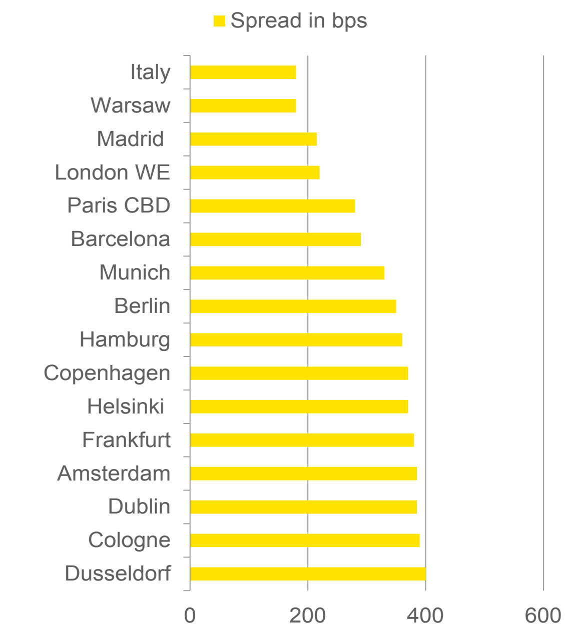
Logistics will increasingly shine in 2017 boosted by the growing share of e-tailing. Notably demand for small units "near-shoring" city centres.
Over the past years, delivering goods into cities has become an increasing challenge due to growing traffic congestion and increasing level of pollution. We believe demand will rise in all large European urban hubs but investors will concentrate on those where retail sales are expected to rise and where the level of broadband access is high (notably London, Paris, Stockholm and Dusseldorf).

Retail: convenience vs destination

The retail sales volume is slowing down, the annual growth expected this year is 1.8% on average in the EU28 against 2.5% last year. At the same time, online retail sales are expected to grow by approximately 16%, which clearly suggests the decreasing share of in-shop sales and explains retailers' struggling in secondary

GRAPH 1

Bond yields vs Prime office yields The spread will remain attractive in 2017*



Graph source: OECD, Savills /* year-end forecast locations. Prime locations in today's new consumer behaviour means "next door" since the delivery time has shrunk to one hour. Performing out-of-town centres will have good F&B presence and provide leisure facilities and services to trigger consumers' interest and make them use their car and spend the time to go on-site.

The retail segment will continue to attract investor interest, but this will continue to be towards the best retail locations. Refurbishment and active management of older secondary schemes may offer value add opportunities.

Demographic assets and income stream assets

Any assets for which, the demand is expanding exponentially, fuelled by strong demographic trends and for which, the level of supply is far from meeting the demand, will increasingly catch investors' interest, especially since they provide long term stable cash flows. Some markets, notably student housing in the UK, Germany, France and the Netherlands, have reached good levels of liquidity thus putting downward pressure on prime yields and slowly closing the yield gaps with traditional commercial assets. In the most established markets,investors should pay strong attention to the development pipeline.

Less established markets may provide a wide range of competitive opportunities to investors, including care homes in Germany, France, Finland, multi-family in the Nordic region and Germany, micro living in the Netherlands in Germany and private clinics in France.

Big is beautiful: big data in big datacentres

The Internet of Things is driving an incredible growth of data volume. And for big data to become a reality, data needs to be hosted and stored in datacenters for further processing and analysis. All this cloud growth directly drives the need for datacentres, notably super-sized infrastructures. Multi-tenant facilities are expanding, which maks sense as sharing infrastructure, especially power and cooling, reduces costs.

Since the need for datacentres is likely to escalate exponentially in the next five years, a growing number of investors is looking at this new asset class. This is particularly true in the Nordics due to natural cooling efficiencies but also high connectivity, lower power costs, abundant resources of green energy and finally taxation incentives. This is also the case in the UK and in Belgium.

> "In 2017 investors will have to look at the edge of the most established markets to find good opportunities." Lydia Brissy, Savills European Research

Co-working places, an alternative to the office shortage

The craze for co-working spaces is far from fading. On the contrary, there are currently 13,800 co-working spaces in the world; 22.1% up on last year according to Deskmag who forecast that by 2020 the number of space will have nearly doubled. Europe, if not the historical cradle of co-working space, is the continent that hosts most of these spaces. These new working spaces, initially mainly appealing to start-ups, solo workers and freelancers is increasingly attracting corporations.

Some market players within the co-working space industry have already set a global footprint, notably Impact Hubs, WeWork, both privately owned. They offer investors the opportunity to capitalise on the locations in high demand for work space. Spain, Germany, France, the UK, Italy, the Netherlands and Belgium are particularly popular countries for co-workers and co-working spaces.

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