

# Briefing note

January 2012

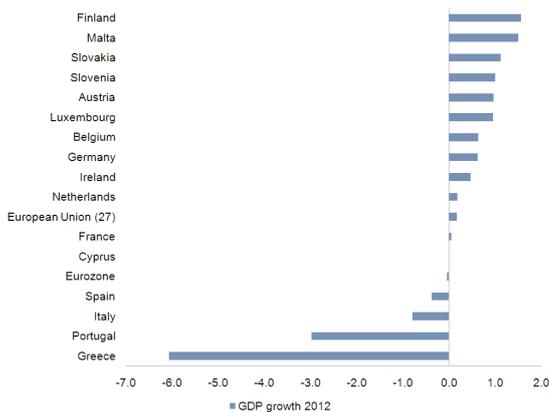
## 2012 European investment trends

**The deterioration of economic outlook will have a negative impact on investor sentiment and market fundamentals. The focus will remain on prime, core markets and the disparity between prime-secondary and core-periphery is set to widen.**

### Economic outlook

The deterioration of the macroeconomic outlook in Europe over the final quarter of 2011, and the unsatisfactory outcome of the December EU summit have sparked a growing concern about some countries ability to pay their debts. The consequent renewed liquidity crunch in the European banking system, has had an immediate impact on business and consumer accessibility to finance also causing a deterioration of confidence. According to Oxford Economics the slowdown of the economy in 2011 is set to become an outright double dip in most parts of Europe, forecasting a -0.2% quarterly growth for the first quarter of 2012 in the Eurozone. Growth for 2012 as a whole has been revised down from 1.1% to 0%.

### Eurozone GDP growth forecast 2012



Source: Oxford Economics

The outlook for individual countries varies, but Austria and Scandinavia are expected to outperform on relative terms, growth by just below 1%, while France and The Netherlands are forecast to be broadly flat.

Spain and Hungary are set for at least another year of contraction of output and the most dramatic falls are expected in Portugal and Greece.

### Impact on investment activity

The ongoing speculation on Europe's and Euro's fate has negative implications for the European property investment market. Transaction activity has been adversely affected with more restrictions on lending and access to debt, especially for non-core stock and countries with perceived currency risk. Although half way through last year we noticed some specialist players to start exploring the best opportunities in the secondary market segment, we believe that this year investors will focus mainly on risk-averse investments. Overall in 2012 investment activity is expected to be affected by the impact of the deterioration of economic outlook on market fundamentals and on investor sentiment.

With regards to market fundamentals a marginal pickup in demand last year, combined with the ever declining rate of development completions has improved slightly the overall vacancy rate indicators in most prime office markets and high quality shopping centres, thus maintaining on average a low but positive rental growth trend. We expect this trend to soften in 2012, as unemployment is forecast to rise in most European countries and investment intentions to be scaled back, having a negative impact on both office demand and consumer confidence. We expect to see more positive trends in demand after 2013, when unemployment will start falling in most European economies, according to Oxford Economics. Over the 2014-2016 period the Eurozone growth will reach an average of around 2% per annum.

With regards to investor confidence it is likely to affect

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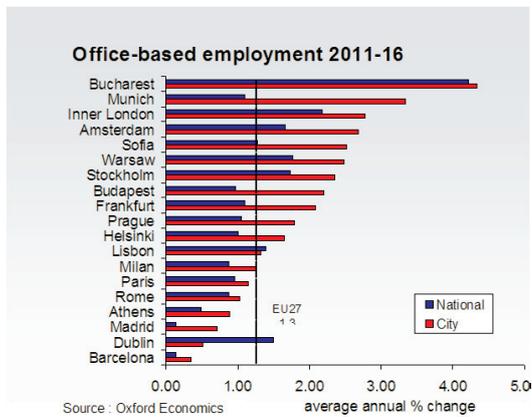
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the volume of market activity if investors avoid or delay investment decisions. On the assumption that a disorderly Greek debt restructuring is avoided, with a prolonged slow economic growth and slow recovery, as opposed to deeper recession across all European economies, we expect investor focus to remain on prime assets (offices and/or retail) in core markets, such as London, Munich, Amsterdam, Warsaw, Stockholm and Paris. These markets, according to the base scenario of Oxford Economics forecasts, are expected to outperform on a regional level the average national and European growth levels in terms of employment creation, output and retail sales.

## European office employment 2011-16

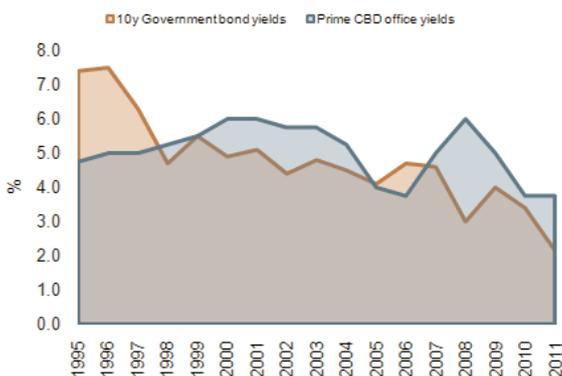


Source: Oxford Economics

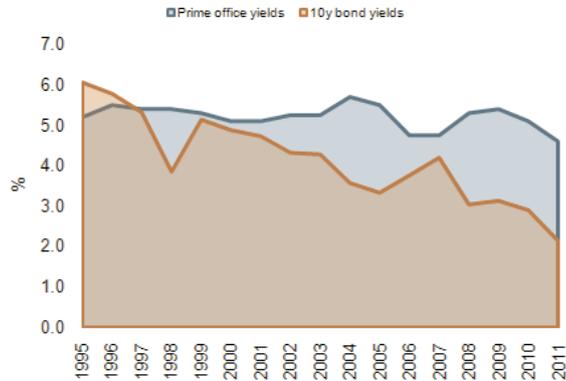
## Pricing trends

Currently, the uncertainty with the debt exchange in Greece is leading investor demand to less risky debt pushing government bond yields down at historic low levels in markets with larger and more stable European economies, such as Germany, and Sweden and to a lesser extent the UK and France – especially following its recent loss of its triple-A credit rating. We anticipate that under the base economic scenario, this may sustain prime pricing levels in the real estate markets in these locations as property risk premiums over government bond yields remain wide.

## Bond yields vs prime office yields - London



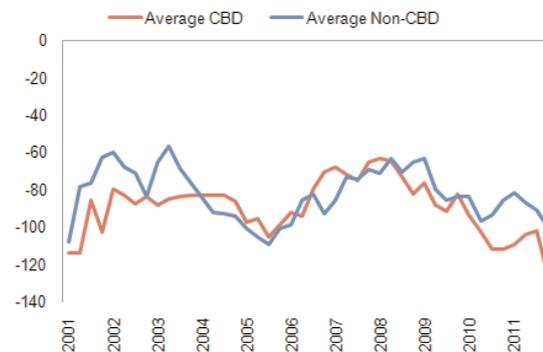
## Bond yields vs prime office yields - Frankfurt



Source: Savills Research

On the other hand the lack of bank lending for non-prime assets and the renewed sense of uncertainty is likely to intensify the prime-secondary yield gap, which has started to narrow since Q1 2011, as investors become more reluctant to invest in riskier assets and focus on 'high quality income' assets, particularly in the core European markets.

## Prime - secondary prime office CBD yield gap



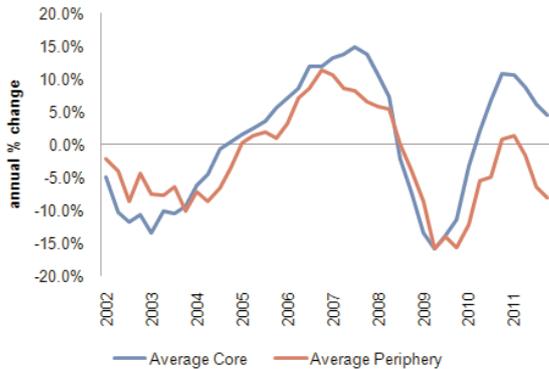
Source: Savills Research

## Core vs Periphery

Investor focus in core markets is also leading to a disparity between them and the peripheral markets of Europe (Greece, Portugal, Spain, Ireland), where the pricing of higher risk dictates higher spreads. The current economic uncertainty and the perceived currency risk may deteriorate investor sentiment and harm further rental and capital values during 2012 in the peripheral markets. The situation is likely to stabilise in 2013-2014 as gradually the peripheral economies return to a slow positive output growth and positive office-based employment creation, although retail sales should still remain under pressure as consumers remain under the impact of heavy austerity measures.

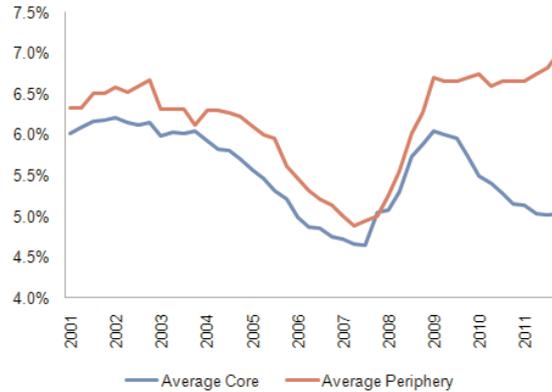
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## Core vs Periphery prime CBD office rents



Source: Savills Research

## Core vs Periphery prime CBD office yields



Source: Savills Research

## European Key-Markets prime CBD rental index

Source: Savills Research

In a wider asset allocation context we believe that prime property will remain a strong buy for investors, especially the ones that are looking for secure, long term income stream. We expect markets with good fundamentals, balanced demand and supply and stable prime rents to attract most investor interest, although as we are approaching the bottom of the cycle in the higher risk markets, some opportunities may emerge for investors with a long-term investment horizon.

Note: Core markets include Brussels, Paris, Berlin, Frankfurt, Amsterdam, Oslo, Stockholm, London. Periphery markets include Athens, Dublin, Milan, Lisbon, Madrid

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