savills

Briefing note
Themes for European property in 2016

January 2016

Modest growth expected
The recovery in the EU area is set to strengthen amid more challenging global conditions, helped by accommodative monetary policy and lower oil prices, which will continue to support private spending. Eventually, the increased inflow of asylum seekers into the EU should result in additional government spending in several Member States. However, employment growth in both the euro area and the EU is still only forecast to be 0.9% in 2016. GDP growth in Europe is looking to come in at 1.8% in 2016 according to Oxford Economics. The main imminent uncertainty clouding the European landscape is the future British referendum and the potential Brexit outcome.

The last in the property cycle will be the winners
Strengthening confidence in the occupational market will bring further appeal to the European property market already benefiting from a positive spread between bond and property yields. Commercial real estate will remain one of the best places for investors to earn decent yield. We expect the recent US interest hike will have a limited impact on the Euro-zone and interest rates in Europe will remain low.

Hence, we anticipate the total turnover in 2016 to be up 3-5% on 2015, the latter already 17% higher than 2014. Investment volumes will be more evenly spread across the different countries with the share of the top three countries (UK, Germany and France) still dominating. In the battle to catch the property cycle, countries in the tail of the wave will be the winners in 2016. Interest from overseas investors will continue, notably from the US and Asia. We also expect the share of European cross-border investments to increase.

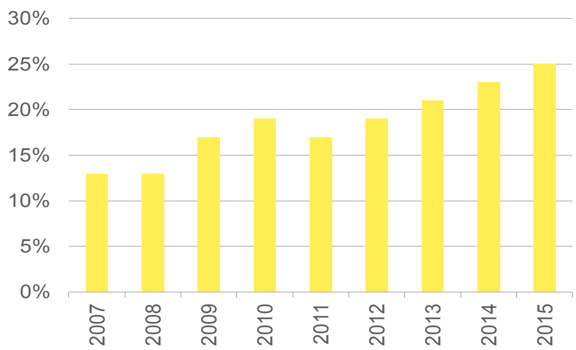
Investment volume expected to grow by 3-5% in 2016

Customised retails
2015 has witnessed the sale of numerous retail portfolios, some pan-European. We expect this trend to continue in 2016 notably as some retailers are looking to unload real estate to invest back into their core business. Prime dominant shopping centres in strong catchment areas in terms of population, tourism and affluence will remain the winners in the retail scene. They will continue to attract shoppers and visitors and whether they generate sales onsite or online, retailers will want to expose themselves to the consumer via these shopping, leisure, lifestyle and custom matched experience destinations. London, Paris, Munich, Madrid, Berlin are some examples of cities which are expected to show strong population growth over the next decade in the context of the fast urbanization trend and which will remain amongst Europe's most affluent catchments.

...brings logistics in its wings
Demand for logistics space will further strengthen, backed by increasing retail needs. E-commerce in Europe grew by 22% pa last year and it is expected to expand further in the next years. This will create higher demand for warehousing space and distribution networks in all large urban areas. We expect development activity in the sector to grow next year since internet retail needs differs from the traditional logistics channel. Suitable supply will come under pressure, with relatively limited knock on effect on rental values depending on cities. Investor interest in the E-commerce delivery battle will grow further, with a particular appetite from US investors for this new type of logistics warehouses.

Beyond the traditional options
Alternative assets have become popular in recent years for various reasons. It is a way to provide greater diversification while avoiding fierce competition for highly priced traditional assets. The less cyclical or even counter cyclical nature of specialist property is also appealing to investors, particularly in a volatile market. But most importantly this is the long term inevitable trends behind the property needs securing long income stream that fuel investor interest, the main one being the demographic changes.
The ageing population in Europe and

GRAPH 1
Alternative investments 1/4 of the total turnover is invested in non-traditional assets



Graph source: Savills

the profile and affluence level of the ageing 'baby boomers' means that there is a need for more and better healthcare facilities, which will offer a wide spectrum of services and support. With the high level of indebtedness of some European governments, it is unlikely that the public sector will be investing in these types of facility in places such as Spain, Italy, France and elsewhere. Investing in private clinics, care homes etc especially in markets with above average affluence levels, such as the UK, Germany or France, is a trend that has already emerged.

Another growing trend includes, the rising numbers of single households in big cities due to ageing population, smaller households, or growing number of immigrants and students is translating in demand for affordable 'micro-living'. Investing in student housing and micro-apartments in cities with large student communities and urbanization trends is something that we have also already seen happening in the UK, Netherlands or Germany and accounts for a rising share of investment activity. We expect this trend to expand to mega cities (London, Paris, Berlin, Madrid, Munich) but also in growing innovation hubs such as Dublin, Barcelona, Amsterdam, Stockholm.

Smart cities, smart companies, smart offices

Innovation sectors are expected to grow fast over the next decade in Dublin, Madrid, London, Barcelona, Warsaw and this should attract a talented young and old workforce. Many of these people expect their cities to be smart, sustainable and to offer a good lifestyle. Sustainable buildings are increasingly popular with innovative companies with corporate responsibility high in their and their people's agenda.

No space for small entities

If tomorrow is not about gigantism, competition to survive will lead to IPO and M&A in many sectors. We expect a growing number of external growth transactions, which will impact all segments of commercial property market, including office mainly but also retail, logistics and investment companies. This will drive consolidation strategies and large tenant needs with large property portfolios changing hands.

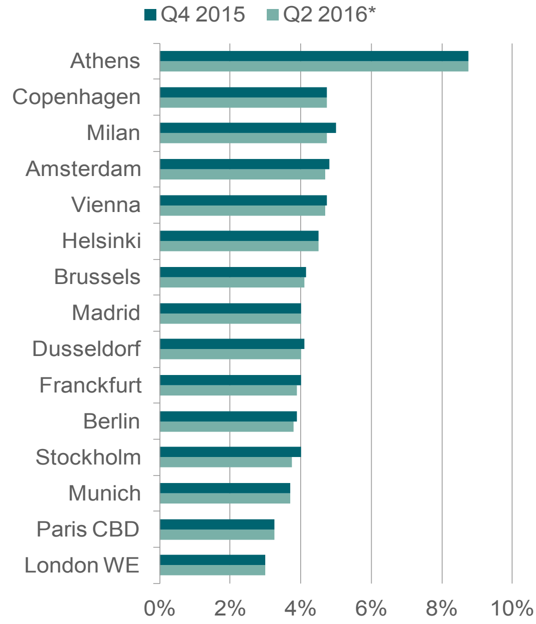
Time to refurbish?

In today's property market there is no room for obsolescence. In spite of very low development activity in the past two-three years, the average European office vacancy rate in the cities we cover is 8.4%, of which we estimate around two thirds is old. Refurbishments, conversions and the use of new technologies can add value to such properties. In London, Madrid, Milan, Vienna, Paris, Stockholm and Amsterdam an increasing number of buildings are being converted from offices to residential or hotels, or redesigned and reused in retail, cafes or restaurants. Alternatively some offices are simply refurbished and upgraded to gain green certificates and attract new office occupiers. The old continent may offer many of these opportunities.

GRAPH 2

Yield hardening still expected

Especially in peripheral countries



Graph source: Savills/*Forecast

Property choice widening, yield gaps closing

The range of property choice has never been so large. We expect yield hardening on prime opportunities to slow down, to accelerate for secondary opportunities and to start for tertiary options. All gaps will close, between core and peripheral countries, between capital and regional cities, between A and B locations and between assets classes.

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

Eri Mitsostergiou
European Research
+40 (0) xxxxxxx
emitso@savills.com