SPOTLIGHT
Savills Research

European Investment

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● European investment trends ● 2020 Outlook ● Rental growth and yield projections

> Alternatives, Multifamily and Retail sectors underpinned Q1 figures capturing over half of the investment activity

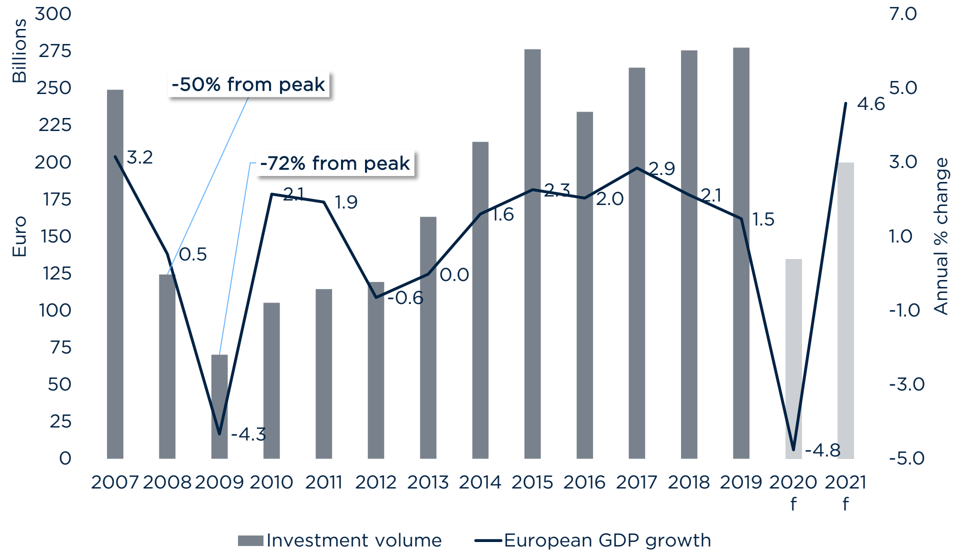
From a V to a U
As health professionals point to falling coronavirus cases across much of Europe, questions are mounting as to the speed of return to normal working practices and the impact on the economy.

Government stimulus packages are keeping Europe's economy on life support, with public debt levels forecast to rise by an average of c20% in the Eurozone (EZ) area, in order to maintain employment levels through furlough schemes. The optimism for a V shaped recession with a strong bounce back is waning, with the unemployment rate forecast to rise from 7.4% at end 2019 to 9.3% by the end of 2020.

GDP growth figures during the first quarter of the year showed -5.8% for France, -5.2% for Spain, whilst Germany is expected to be the least affected major European economy. However, we expect the true depth of the negative spike to be revealed in the Q2 2020 figures as the full weight of the lockdown only came into play during the second half of March.

On a brighter note, a number of European economies are beginning to lift some lockdown restrictions as office workers gradually return to the workplace.

European investment activity in Q1 2020 increased by 46% yoy



Source: Savills Research, Oxford Economics

European investment

Q1 2020 was surprisingly resilient

Portfolio deals accounted for 40% of the activity

• Investment activity during the first quarter of the year has been surprisingly resilient. Over €70.6bn worth of real estate was transacted across the markets we monitor, 46% higher than Q1 2019 and 25% above the 5 year average, but 29% below Q4 2019. The majority of the deals closed over this period were already under negotiation and volumes do not reflect the impact of the lockdown measures, which were imposed in most European countries in March.

• The sectors that underpinned Q1 figures were mainly Alternatives (120% yoy, €15.1bn), Multifamily (66% yoy, €10.9bn) and Retail (55% yoy, 11.4bn). Ten portfolio deals of a value of over €28bn were responsible for almost 40% of the activity, almost three times higher than the first quarter of 2019.

• Offices captured the highest share of activity once again at 33%, driven by some mega deals such as the €1.2bn sale of Finance Tower in Brussels to Valesco Group and the acquisition of OP Financial Group headquarters in Helsinki by a South Korean-Finnish investment consortium for €480m. The investment consortium includes the Finnish Varma Mutual Pension Insurance Company as well as the South Korean NH Investment & Securities and Shinhan Investment Corp.

• Alternatives (21%) and Multifamily (15%) increased their shares above the 5 year average of 16% and 12% respectively. The acquisition of the largest privately-held residential portfolio in the Czech Republic by Swedish real estate company Heimstaden for €1.3bn is a good example of investor appetite for apartments.

• Counter intuitively, retail performed well last quarter at €11.4bn, a 55% yoy change. Once again some portfolio transactions, such as the sale of 50% share of the Sonae Sierra and APG Iberian portfolio to Allianz and Elo for €525m, underpinning the volumes. Nevertheless, the sector continues to capture less share of the total activity compared to its five year average (16% vs 19%).

• These mega deals of over €0.5bn or even over €1bn were responsible for the strength of the first quarter in markets such as Portugal (264% yoy), Spain (109% yoy) and Poland (108% yoy).

• Germany captured over one third of the activity (35%), followed by the UK (23%) and France (11%), overall core markets accounting for about 68% of the total, which is slightly below the five year average of 70%. London was the most active capital city (€6.4bn) with Berlin and Paris in second and third places respectively and similar volumes of about €4.6bn.

• The share of cross border investment was at 61% on average, a particularly active quarter for international investors as it compares to 54% in Q1 2019 and 51% in Q4 2019. The highest cross border activity shares were seen in CEE markets and Iberia.

• Overall European cross border players were the most active, capturing 54% of the total, followed by American investors at 35%, both up compared to Q1 2019. In the beginning of this year

61% The average share of cross border investment in Q1 2020. The highest cross border activity shares were seen in CEE and Iberia.

Over €70.6bn worth of real estate was transacted across Europe 25% above the 5 year average

Investment in Alternatives increased by 120% yoy and in Multifamily by 66% yoy

European cross border players captured 54% of the total activity

Prime office and logistics yields remained stable compared to Q4 2019, but prime shopping centre yields moved out by 28bps

This year we predict prime office rent corrections between -2% and -10%, but the next five year average remains positive at 2%

Asian investors were noticeably less active, representing just 5% of the investment value compared to 14% last year. The countries where European investors dominated with over 85% share of cross border capital were Czech Republic, Finland, Luxembourg and Germany, while Americans were more competitive in the UK (61% of cross border), Ireland (40%) and France (31%).

Post lockdown trends

• The quarantine has brought economic activity to a halt, and despite measures taken by governments to address the negative effects, businesses viability, particularly SME's, is tested. Economists are projecting an economic contraction between –4% and –13% for Euro Area this year. At the time of writing of the report, a rising number of countries are taking small steps towards a "new normality". However, it is evident that the recovery process is going to be slow and volatile.

• Latest RCA figures show that real estate investment in April almost halved compared to the same month last year and was 9% yoy down since the beginning of the year. Savills data show that April in Germany was the weakest since 2012 while in the UK January to April volume was -4% yoy. This is not surprising, as travel bans and negative sentiment have blocked transaction activity with only a few deals progressing. Some small price adjustments (5-10%) have already been observed, while in other instances deals have been put on hold or fallen through. Latest Savills data from Spain show that 15% of the deals have failed to complete in April.

• Rent collection levels will impact investor perception of quality and resilience. Overall in April we observed that office rent payments were close to 80% across Europe, logistics at about 76% on average and retail below 50% in most countries.

Covid-19 implications by sector - Offices

• The debate about the role of the office will continue and we already see some large occupiers announcing their intention to reduce their office footprint. The risk of business failures, when the government support safety net is removed, is elevated. This could lead to a rise in vacancy rates and rent adjustments. With vacancy rates at record low levels (4.9% on average across Europe) and a development pipeline which corresponds to about 50% of a year's take up, the market can absorb a rise in availability without a major negative impact on prime rents.

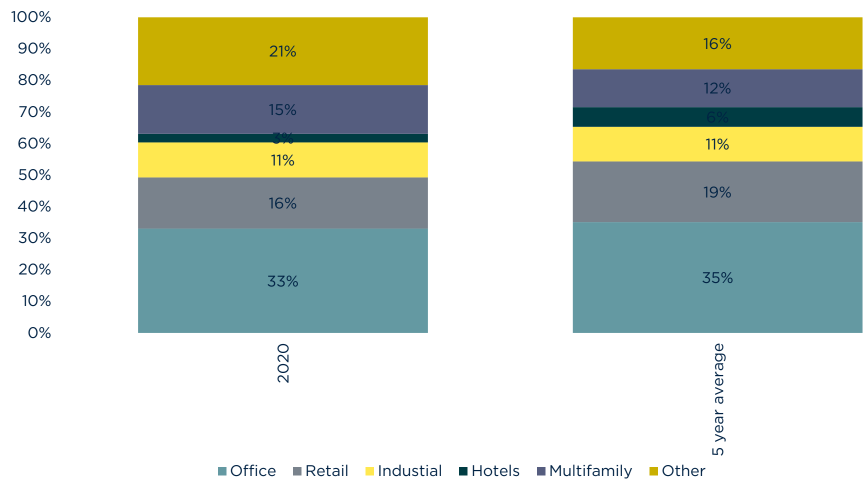
• Flexible office space on the other hand, may need to reconfigure in the short term to meet the current requirements for social distancing and hygiene standards in order to regain its lost occupancy levels, but going forward we expect it to play an important role for corporate property strategies, offering the benefit of short term leases and access to multiple locations. Therefore, any future rise in traditional office availability could be partly absorbed by flexible offices, as well as by alternative sectors of growing importance, such as life sciences, healthcare and residential.

• This year we predict prime office rent corrections between -2% and -10%, while the average five year prime rental growth forecast remains positive at 2%, which should maintain investor interest in the sector. Cities with above average rental growth prospects (2.0%-2.5% pa on average) are Amsterdam, Stockholm, Barcelona, Berlin, Copenhagen and Madrid.

Logistics

• Structural tailwinds and the search for long-term income will continue to underpin investment into logistics, which coupled with demand and supply imbalances and a significant volume of un-invested capital should support market activity and protect pricing going forward. Leasing demand for logistics should remain resilient during 2020, with online retailers and 3PLs competing for remaining logistics facilities (average vacancy rate is at 4.8%) in response to increased online retail spend by consumers. According to our local experts demand from occupiers for

European investment by sector offices captured the highest share in Q1



Source: Savills Research

> "High liquidity, low interest rates, constrained development pipelines and a better capitalised banking sector should contribute to a faster recovery of investor sentiment than the post GFC"

logistics space in April was unchanged or rising in two thirds of our markets. Despite low vacancy rates the anticipated rental growth for 2020, may be delayed until there is more clarity about the economic implications of the health crisis.

Residential

● Multifamily is perceived as a defensive sector, with demand for housing driven by non-cyclical factors. Urbanisation, shrinking households and rising house prices have been driving demand for rental and the trend may intensify further during a period of uncertainty. In 57% of our markets we have observed in April that investment activity in residential has remained stable. Rental growth is expected to freeze in the medium-term, however, the demand and supply imbalance for rental stock that is observed in many European cities (such as Amsterdam, Copenhagen and Frankfurt) will persist as construction activity slows down, maintaining the long term fundamental strength of the sector.

● The reliance of Purpose Built Student Accommodation (PBSA) on foreign students and especially Chinese will be the biggest risk for the sector. The negative impact on PBSA rental income is estimated to last between a semester and a full academic year. What will happen beyond this time frame will depend on student mobility trends going forward. Past experience shows that education comes out stronger in periods of uncertainty. We believe that the most resilient markets for student housing now will be the ones with demand and supply imbalances for mainstream student accommodation, which targets mainly the local student populations and where the student housing product has less dependency on international students such as Spain, Netherlands and Ireland.

Hotels

● Confidence in the longer-term fundamentals of the hotel sector remains; interest for development sites in core destination markets continue with a number of investors seeing the current situation as an opportunistic play. Despite this, we will see a significant decline in transaction volumes over the course of the year. This was already apparent in monthly transactions with European March volumes down 77% on the three-year average for March, with April volumes down 63%. This suggests year-end transaction volumes could be at or below GFC levels with an improvement in volumes forecast for 2021.

Retail

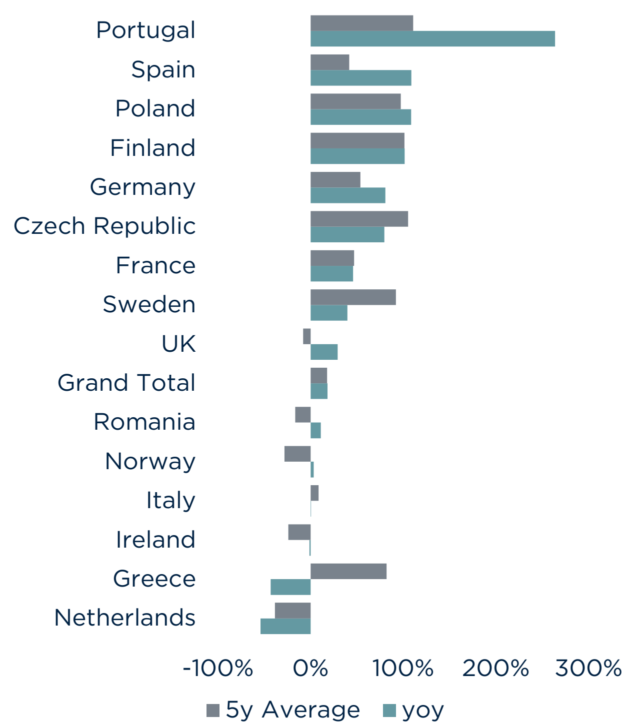
● The lockdown has had a dramatic effect on the retail and leisure industry, with only "essential retailers" allowed to stay open, including supermarkets, pharmacies, food stores, petrol stations and others depending on the country. Even after reopening, social distancing measures will restrict significantly the typical flow of consumer trade. In the meantime confined consumers have shifted towards e-commerce, forcing many retailers to upgrade their omni-channel strategies. The health crisis has accelerated the structural changes that were already underway and we expect further retail store rationalisation and downward pressure on rents. Convenience and food retailing have proven to be the most resilient during this crisis and out-of-town retail has the potential to recover sooner, as it can more easily meet the requirements for social distancing. In 73% of our markets retail capital values have shown further signs of softening in April, which can lead to value-add opportunities in the coming months.

First signs of yield softening

● Prime CBD office yields remained broadly stable on a quarterly basis in Q1 2020, at 3.84% and 12 basis points below Q1 2019. Only Luxembourg moved in 25bps to 3.75%, while Prague and Warsaw moved out by 10bps to 4.0% and 4.35% respectively.

● Average prime industrial yields also remained unchanged on a quarterly basis and 22 bps below last year's levels at 4.93%. Rotterdam (4.25%),

European investment trends Q1 2020 Iberia, CEE and Nordics had a strong first quarter

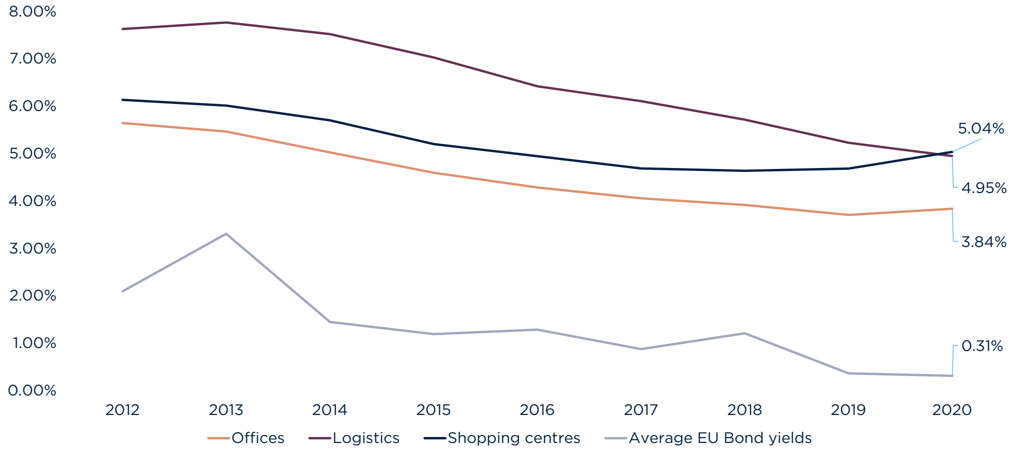


Source Savills Research

Investment in capital cities London was the largest market in Q1

Source Savills Research

Average prime European yields Prime logistics yields have dropped below prime shopping centre yields



Source Savills Research, Focus Economics

Oslo (4.55%) and Dublin (4.75%) experienced a 25bps inward yield shift compared to the previous quarter, while prime yields moved out by 25bps in Amsterdam (4.5%) and Prague (4.5%).

- Prime shopping centre yields have moved out by 28bps on average across Europe compared to the previous quarter and by 39bps compared to last year to 5.1% and are now for the first time higher than prime logistics. The most significant yield softening in one quarter were noted in Czech Republic (75bps to 5.75%), Netherlands (50 bps to 5.5%), Ireland and Norway (50bps to 5.0%) and Sweden (50bps to 4.75%).

Uncertainty will constrain investment volumes this year

- We expect short-term headwinds to have a negative impact on deal flows over the next three to six months. Most investors will keep searching for opportunities, but transaction activity should resume along with the lift of lockdown measures, the revival of economic activity and the reopening of flights. Post GFC investment volumes had dropped by 72% from the peak over a two year period. We believe that this time, high liquidity, low interest rates, constrained development pipelines and a better capitalised banking sector should contribute to a faster recovery of investor sentiment. In most markets we have indications that investors remain active particularly in the prime market segment, with several deals in progress and minimal price discounts. Secondary and value-add market segments are more exposed due to mismatch between buyer and seller pricing expectations.
- Highly liquid markets such as London, Paris, Berlin and first tier German cities as well as markets with good long term rental growth prospects such as Stockholm, Amsterdam and Madrid will continue to attract investor interest, but volumes will be constrained by lack of prime opportunities compounded by a shortage of willing sellers. Sale & leasebacks may be more prevalent in the next quarters, as a defence strategy of troubled occupiers to boost cash flows. This could lead to opportunities in the retail, hospitality and other operational sectors. Off-market deals and joint ventures to support development financing, will also underpin deal flows in the short term.
- Domestic players and international funds with a good network of European offices should be the ones to progress faster. Asian investors may be absent for a while, or act through European fund managers, where possible. As lenders are becoming more cautious, equity players and private investors will have a competitive advantage.
- Our optimistic projections point to 34% yoy drop of investment volumes by the end of 2020 across Europe to €170bn and our pessimistic ones to a 52% yoy drop to €125bn, similar to post GFC contraction (-54% to €124bn). Pent-up demand for real estate investment by cross border institutional investors in particular, should lead to a swift recovery of activity next year.
- With regards to pricing, we anticipate some price softening, as the market is not underwriting the rents and capital values pre-Covid 19, but are factoring in a more pessimistic outlook. Nevertheless, we do not expect prime yields to correct to the extent they did post GFC, as return requirements above the risk free rate remain satisfactory.
- We expect prime office yields to remain stable in the majority of our markets by the end of the year. Most significant outward yield shifts (30-50 bps) are anticipated in Prague and Warsaw.
- Small price corrections are anticipated in the logistics sector, where prime yields in more than half of the markets are expected to move out by 10-20 bps at the most. Budapest and Oslo anticipate even a small yield compression of 5bps.
- We expect prime shopping centre yields to continue softening across all markets, with the most significant corrections (of 50bps or more) in Spain, Czech Republic and Poland.

"NEW NORMAL"

By the end of the year we will know more about the virus, the effectiveness of the measures and the implications on the economy. We will be used to a "new normality", which we may need to adopt for a longer period and which will change the way we live, work and play. The role of technology and the internet of things will be elevated in our lives, but without totally replacing the physical experience. Consumers will go to work, will go out and shop, will book holidays, buy or rent homes and study abroad again, but the requirements and rules may change for users and providers of space alike. Demand and supply will rebalance and the strength of location and market fundamentals will determine the investment hotspots once again.

Naturally investors will be more cautious about the retail and hospitality sectors, which have been disrupted the most by the lockdown, as well as sectors which rely on short/flexible lease models, such as flexible offices and student housing. There is more confidence in logistics, as well as in multifamily, with several transactions in progress even during the lockdown. Prime offices are also considered quite resilient, although the success of the teleworking experiment may have significant implications on companies' property strategies in the future. Besides, the impact of the economic slowdown on occupier demand and rents will be more evident later in the year and in 2021.

-34% to -52%

Is the potential range of the annual drop of investment activity this year, based on our optimistic and our pessimistic scenarios . Post GFC European investment volumes dropped by 54% in 2008.

Savills Commercial Research
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