European Commercial – March 2019

SPOTLIGHT
Savills Research

European Investment

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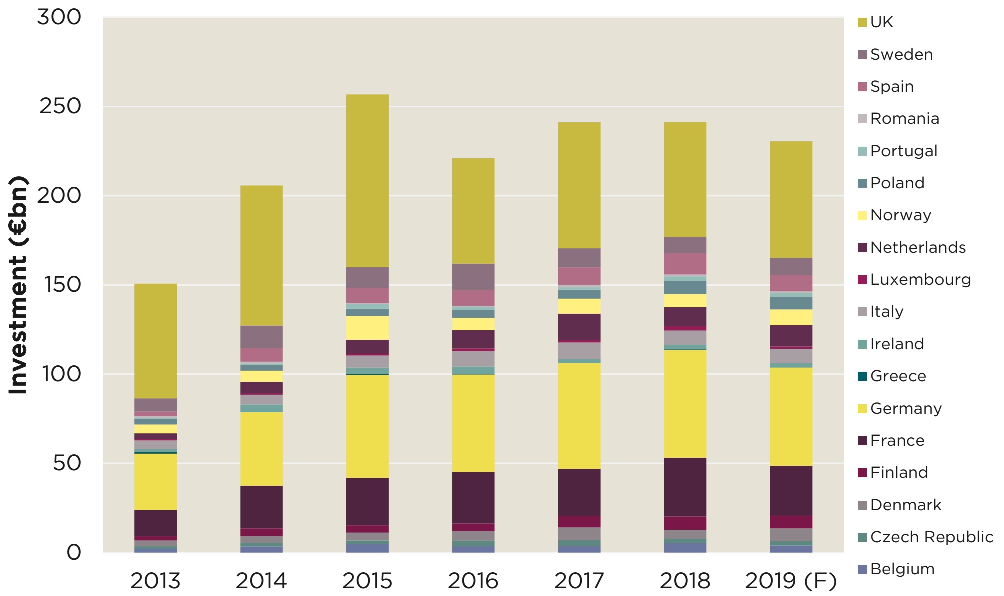
• Alternative Sectors • Yield Compression • Korean Investment

"Poland, Portugal and Luxembourg were among the most active markets for non-domestic investors in 2018."

Chart 1: European Investment Transaction Volumes



Source: Savills Research

ECONOMIC OVERVIEW

After a strong start to last year, the Eurozone's economy lost momentum in the second half of 2018. GDP is expected to have expanded a seasonally-adjusted 0.3% quarter-on-quarter during Q4, a slight improvement from Q3's 0.2% increase but notably below the 0.7% growth seen throughout 2017. The Eurozone's economic momentum dissipated significantly throughout last year, weighed on by plunging confidence, dampened external demand and some political turbulence.

On a brighter note, the labour market continued to tighten in Q4 and wages have been rising, which should help stoke consumer spending. FocusEconomics consequently forecast GDP to increase a seasonally-adjusted 0.4% qoq in Q1 2019, with 1.5% forecast for the full year. Brexit is adding to uncertainty in the UK, as policymakers struggle to find a consensus on how to proceed, which is increasing the chance of a no-deal outcome or extended limbo of negotiations.

Beyond the UK, the threat of rising global protectionism looms large. US President Donald Trump has threatened to levy tariffs on the EU if trade talks flounder, which would dent the Eurozone's growth forecasts. In addition, if negotiations between the US and China continue to concern investors, this could further hit global growth expectations.

2019 European commercial investment volumes forecast to reach €230bn

South Korean investment activity to gather pace during 2019

European commercial investment transactions are forecast to reach €230 billion during 2019 (Chart 1), in line with the previous five year average.

2018 Overview

During 2018, European commercial investment transactions reached €241bn, as geopolitical concerns were brushed aside to leave volumes 3% above the five year average.

Resilient demand for offices (47% of total) and the growth of the alternatives sector (21%) fuelled investment volumes during 2018 (Chart 3).

Industrial investment volumes reached €32bn last year, accounting for 14% of the total investment volume. This was the second highest level of investment on record, after 2017. We expect investor demand for European industrials to intensify during 2019 as e-commerce continues to grow across Europe and competition for prime development plots intensifies.

In 2018, both **France** (€33bn) and **Germany** (€60bn) reported annual commercial investment volumes over €5bn above their respective five year averages, which boosted the total European figures, Savills data shows.

The **UK** (€64bn) received more commercial investment than any other European country, accounting for around 28% of the total. This was 13% below the five year average, however this is partly explained by a weaker sterling relative to the euro; in sterling terms, volumes were only 5% lower. This currency play attracted €6.1bn of cross border investment from the rest of Europe during 2018.

Germany, attracted €30bn of cross border investment in 2018, more than any other European country, with €14bn of this coming from the rest of Europe.

A total of €33bn was invested altogether in **France** during 2018, driven by a record €11bn of Paris acquisitions. France attracted €12.2bn of overseas capital last year, the strongest year on record, accounting for 39% of total acquisitions, up from 25% in 2017.

Cross border investment activity accounted for 50% of the total European investment during 2018 (Chart 4). This marked a slight decrease from 51% in 2017, partly due to the fall in overseas money moving into UK and Netherlands.

Poland, **Portugal** and **Luxembourg** were among the most active markets for

"Office yields are generally expected to remain flat, with Portugal and Greece forecasting further inward movement."

European investment transactions were 3% above the five year average in 2018.

€241bn of investment transactions recorded during 2018

Offices accounted for 47% of investment transaction volumes last year

38% increase yoy forecast for Denmark investment volumes in 2019

HOTEL

Other commercial investments accounted for 21% of total during 2018

non-domestic investors in 2018, with 96%, 89% and 85% of total investment accounted for from overseas investors respectively. Conversely, **Belgium** (35%), **Sweden** (25%) and **Norway** (17%) markets were less exposed to overseas investment than in recent years.

2019 Outlook

Although we do not expect 2019 investment volumes to exceed 2018's levels, this year should see investment activity reach levels in line with the last five year average. **Poland** (+46%), **Denmark** (+38%), **Finland** (+32%) and **Portugal** (+27%) are forecast to see commercial investment volumes exceed their respective five year averages by the most in 2019.

Multifamily investment in core cities with strong demographics will remain high on the wish list of investors this year. In **Netherlands**, for example, we expect total residential investment volumes to be in line with office investment volumes this year.

In what will be an income driven environment going forward, investors will be increasingly looking towards the alternative sectors in search of long income. Investors are becoming more open to data centres, care homes and cinemas secured to strong covenants on long term leases.

Development opportunities will also remain attractive in established office locations as European CBD office vacancy rates have fallen to 6.1% (European Office Spotlight: Winter 2018/19). We expect an increasing proportion of new office and residential space to be delivered in mixed-use schemes as landlords look to diversify their income pool.

Yield Analysis and Outlook

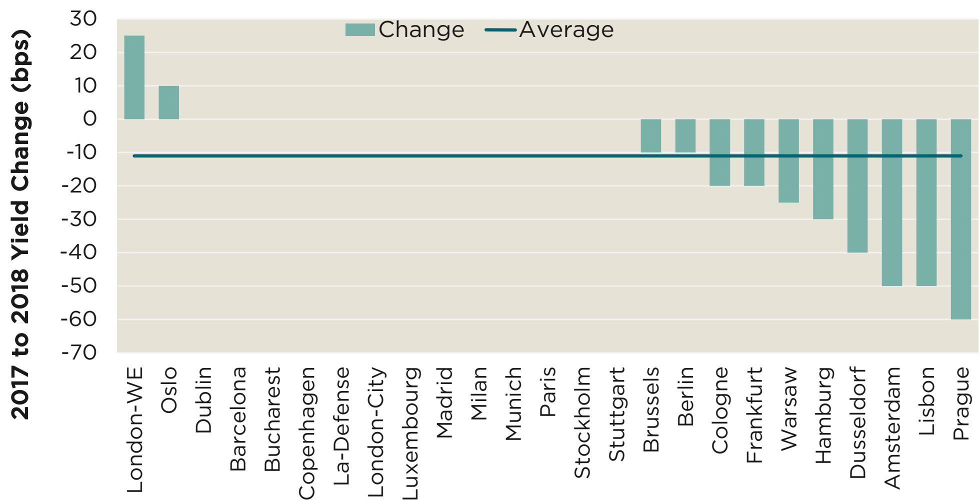
A low interest rate environment across Europe will continue to offer attractive yield spreads for prime commercial real estate. European prime CBD office yields hardened by an average of 11 basis points (bps) from 3.85% at the end of 2017 to 3.74% in 2018 (Chart 2).

Prague offices witnessed the strongest yield compression of 60 bps to 4.25%, still remaining attractive to the European average. Both **Oslo** and **London WE** CBD offices showed slight yield softening by 10bps and 25 bps respectively. However, over half of the European cities' CBDs yields held firm during 2018.

We expect the majority of European commercial property yields to remain fairly stable over the next six months. Office yields are generally expected to remain flat, as investors grow more cautious due to the slowing economic environment. **Portugal** and **Greece** forecast further inward yield movement in this sector, whereas the **UK** has factored in some minor outward shift.

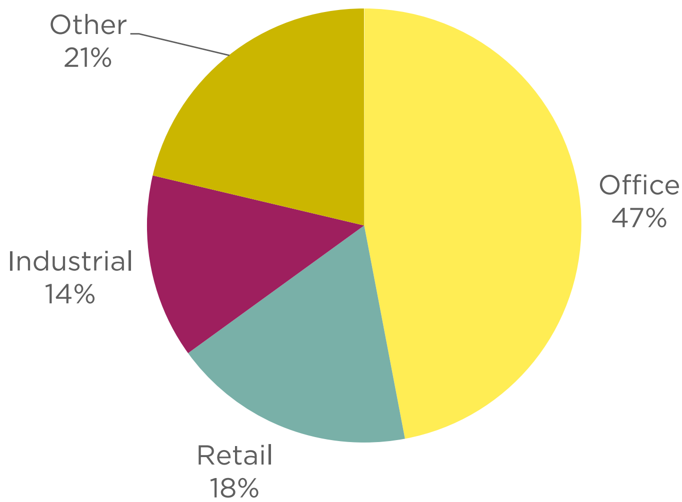
In the retail sector, **Luxembourg**, **Belgium** and the **UK** all expect some outward yield movement during the first half of 2019. Meanwhile, for industrials, **Germany**, **Portugal** and **Spain** all forecast inward yield movement over the next six months, supporting the trend of European cities adapting to the structural growth of e-commerce.

Chart 2: Prime Office Yield Shift 2018 (bps)



Source Savills Research

Chart 3: European Investment by Sector, 2018 (%)



Source Savills Research

Non-European Investment Focus

The amount of non- European capital invested in Europe totalled €57bn in 2018, following a high volume achieved during Q4 18, according to RCA. This was 8% down compared to the previous year but still very high by historical standards (€44.5bn 10-year average).

The UK and Germany absorbed half of all non-European money invested in Europe last year (31% and 19% respectively). Although it appears to be highly concentrated, the destination of overseas money is far more evenly spread across European countries than it was 10 years ago. Back in 2009, the UK accounted for 64% of total investment into Europe, with France (10%) and Spain (9%) the other two major destination countries. Over the past five years, the breakdown diversified with notably growing overseas investment activity in the Netherlands, Poland, Finland, Ireland and Belgium.

The breakdown per asset type is much in line with the overall investment trend. The share allocated to office property increased from 51% in 2017 to 56% last year. Logistics assets also gained ground, accounting for 19% of their total investments in European compared to 16% the previous year whilst at the same time, reducing their retail exposure.

The US remained the major contributor in the European property market accounting for 48% of the non-European volume recorded in 2018, although 9% down compared to the previous year. France became their main targeted destination followed by the UK and Germany.

At the same time, Singapore investments in Europe nearly doubled, accounting for 10% of the total overseas volume. Hence Singapore became the second biggest non-European country investing in Europe, thus overtaking Hong Kong, which significantly reduced its investment activity, historically located in the UK.

South Korean investment in Europe expanded to €5.4bn (+11% yoy in 2018) and was ranked in third position in the league. South Korean investors are still targeting offices in core CBD locations, including Hana Financial's purchase of Trianon, Frankfurt for €670m in Q4 2018, but recently, they have broadened their market coverage to non-core countries, notably Belgium, Poland, Italy, Ireland, Denmark, Czech Republic and Spain, given the compressed pricing environment. One example of Koreans stepping up the risk curve is the €80m acquisition of a Helsinki logistics asset last year.

Longer leases available in Europe, as well as relatively cheap debt compared to the US are among the key drivers for Korean investors. Additionally, there is the ability to secure enhanced returns from currency hedging with up to 150bps spread between the South Korean Won and Euro. The Eurozone will remain attractive as the GBP and USD hedge provides lower returns in comparison. We expect 2019 to see a higher number of large volume transactions which will be dominated by Korean equity and we estimate Korean investment into Europe could reach as much as €4bn during the first quarter of 2019.

The volume of South African capital coming into Europe also increased significantly, by 67% between 2017 and 2018. Their investment activity initially focussed on retail properties in CEE countries, but now also includes logistics assets in the UK, the Netherlands and Poland. For example, South African investment accounted for 32% (€326m) of investment into Romania last year (Table 1).

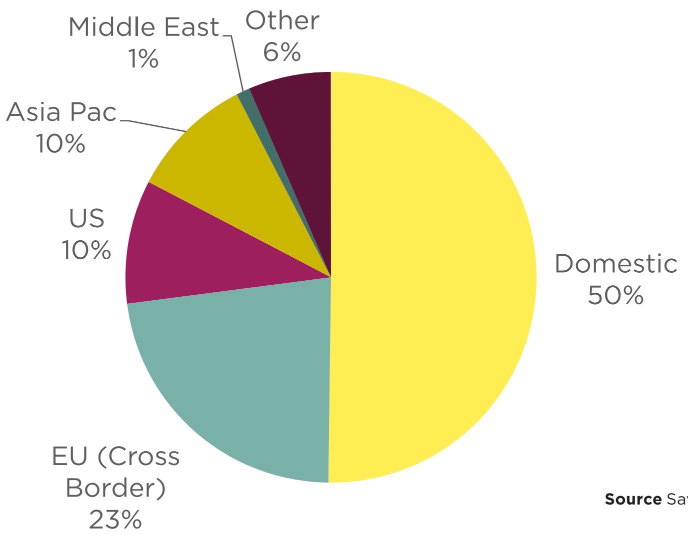
€32bn

Investment in European industrials during 2018, 16% above the five year average.

67%

Increase in South African investment into Europe from 2017 to 2018.

Chart 4: European Investment by Origin, 2018



Source Savills Research

€57bn

Volume of non- European investment into Europe during 2018, of which 50% was invested in the UK and Germany.

Table 1: Non- European Investor Transactions, 2017-18

Origin of buyers	Main investment acquisitions	€bn Invested in Europe in 2018	€bn Invested in Europe in 2017
US	CBD and non CBD offices across EU but mainly in core countries; Logistics across EU	27.4	30.1
Singa- pore	CBD offices mainly UK but also other major EU cities; Logistics UK, Netherlands and Poland, Hotels in major tourist cities	5.6	2.9
South Korea	CBD offices UK, Germany, Belgium and France but recently spreading in Poland, Italy, Ireland, Denmark and Spain	5.4	4.9
South Africa	Retail CEE; Logistics Netherlands, Germany and France; non CBD offices UK and Netherlands	3.9	2.3
Canada	Offices core countries and Netherlands; Hotels UK; Retail Germany, Spain and Belgium	2.9	3.9
Hong Kong	CBD offices UK; Retail London; Hotels UK	2.7	6.3
Israel	Hotels UK, Netherlands; non-CBD offices Netherlands, UK; CBD offices increasingly looking towards central Europe (Poland, Hungary, Luxembourg)	2.1	2.6
Malaysia	Hotels UK, Spain and Netherlands; Retail Poland, UK; Offices Poland, UK	0.9	0.3
Taiwan	CBD offices traditionally UK, big deal in Germany in 2018	0.5	0.2
India	Hotels UK, Germany and Netherlands; CBD offices London	0.5	0.1

Source Savills Research, RCA

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