

European Investment - February 2020

Q  
SPOTLIGHT  
Savills Research

# European Outlook 2020

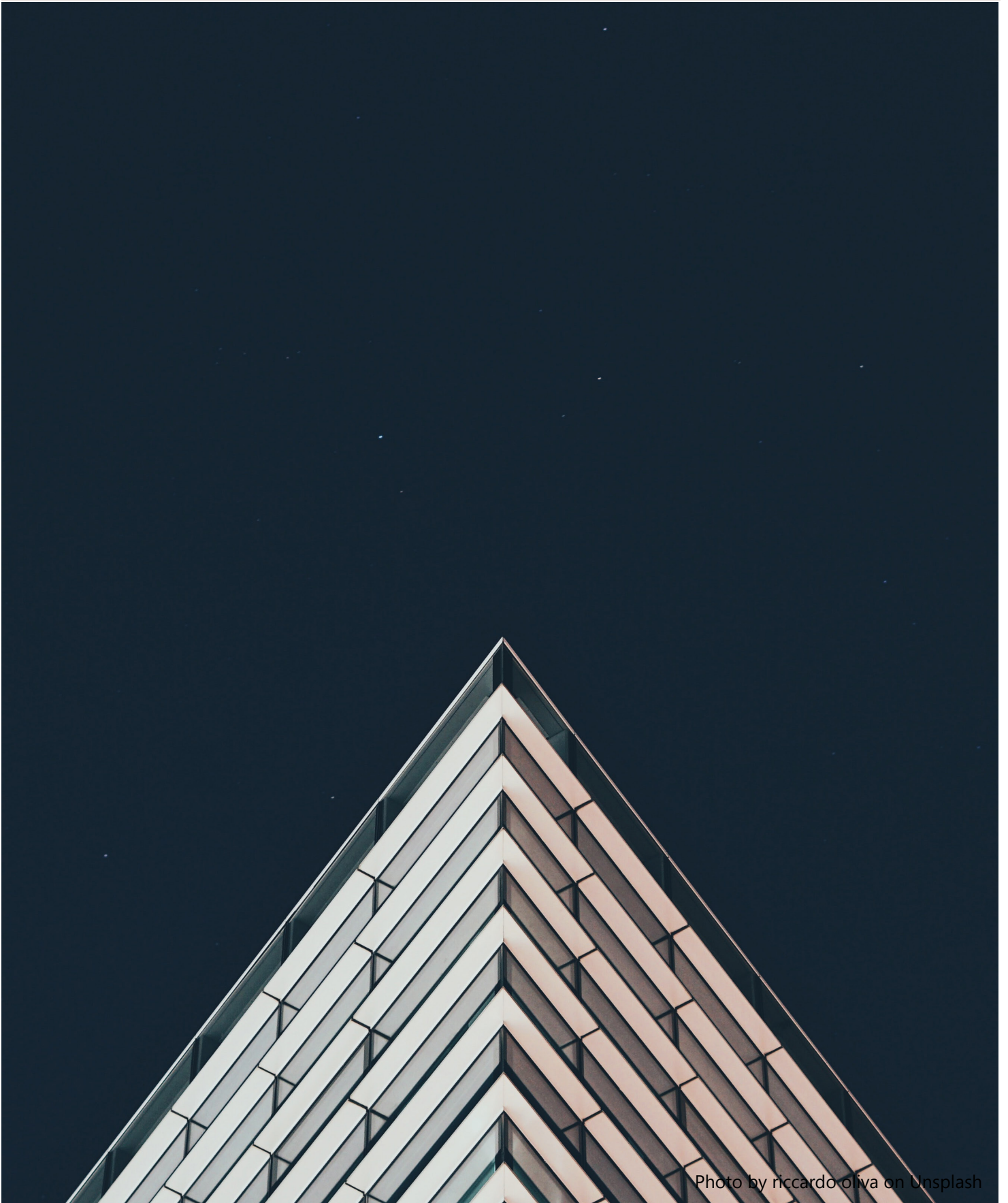


Photo by riccardo oliva on Unsplash

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

Germany was the largest market last year with a total volume of €70.8bn, followed by the UK at €61.3bn and France at €40.1bn

### Coronavirus threatens growth

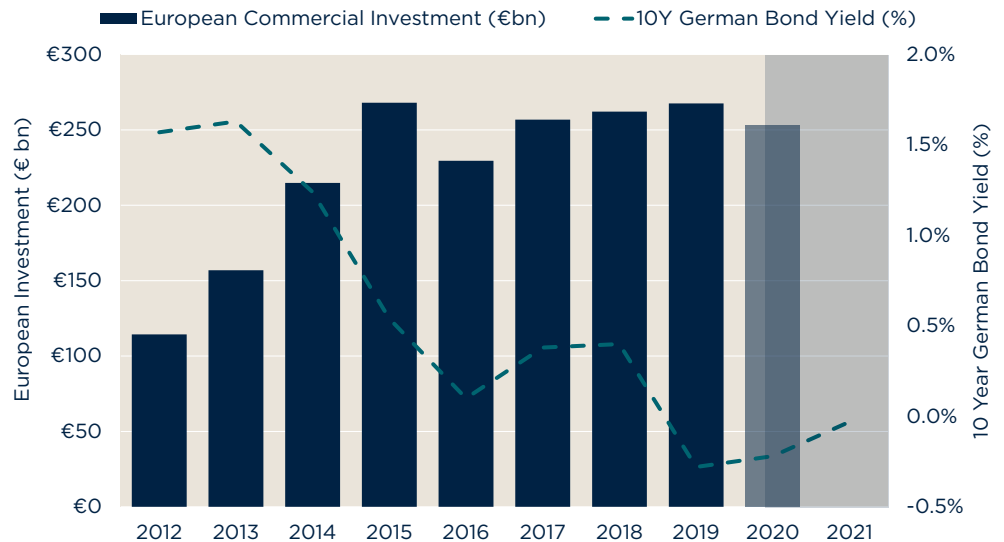
Economic growth in Europe moved ahead only slowly last year, with the total EU GDP growth down to an estimated 1.2%, the slowest pace since 2013. Prolonged weakness in the industrial sector amid global trade tensions, weak demand from key trading partners, and political uncertainty likely hit growth.

The ECB made no changes to its monetary policy on 23 January, and according to President's Lagarde statements it is expected that the Bank will maintain an ultra-accommodative monetary policy for a prolonged period of time, in order to stimulate growth and inflation. She also urged Eurozone countries to adopt expansionary fiscal policies in order to boost growth and push ahead with the implementation of structural reforms.

Weak consumer and business confidence in January–February suggest economic activity will remain weak. Moreover, the outbreak of coronavirus in Italy and its spread to other European countries should have a negative impact on the manufacturing and tourism sectors.

According to Focus Economics Consensus Forecasts this year's economic growth for the Eurozone is projected at 1.0%. In 2021, GDP is seen increasing 1.2%.

European investment activity in 2019 increased by 1.3% yoy



Source: Savills Research

## European investment

2019 was a record year, despite UK weakness

### Germany was the largest market in 2019

- Total European commercial investment activity in 2019 was the second highest on record at €267.6bn across the 20 markets that we monitor. It was 2.1% above the previous year's level and only slightly below the 2015 turnover, which is the highest in our historic series.

- Germany was the largest market at €70.8bn, followed by the UK at €61.3bn and France at €40.1bn, altogether capturing 65% of the total activity. Both Germany and France saw a rise in investment activity, by 9.1% and 17.2% respectively, while another year of political uncertainty has led to another drop in investment activity in the UK, by 18.3% yoy.

- Some of the larger markets that performed well boosting the total were Italy (52.0% yoy) and Sweden (45.8% yoy). Some of the smaller markets also registered substantial growth, such as Ireland (95.7% yoy), Greece (51.1%) and Portugal (17.4%). Even in markets where volumes dropped, such as Finland, this was mostly due to lack of product.

- If we include multifamily investment activity the total investment volume in Europe exceeds €300bn, 1.4% above last year. Ireland and Sweden had particularly active markets in this segment last year.

- Overall domestic investors were slightly more active than cross border ones, capturing 53% of the total activity, however this figure hides some variations amongst countries. Domestic players were dominant in Norway (84%), Greece (70%) and Sweden (64%). Cross border investors on the other hand were dominant in Poland (97%), Portugal (86%) and Luxembourg (76%).

- In terms of nationality, European cross border investors were the most active accounting for 18% of cross border activity, followed by the US at 12%. The share of Asian capital was at 6%, slightly lower than the year before despite the rise of South Korean flows and due to suppressed outflows from Hong Kong and China. However, Asian capital also enters the market via European investment managers.

### Different strategies for different risk profiles

- However, late cycle signs and external threats to the economy, such as political uncertainty, trade tensions and the impact of coronavirus call for vigilance. Investment strategies vary: flight to safety, diversification of sectors or geographies, focus on countercyclical sectors or sectors that benefit from structural changes, moving up the risk curve.

- Investors remained loyal to offices last year, which accounted for 40% of the investment activity, up from 38% the year before. We expect another strong year of offices, as we believe that core strategies will prevail. Some new developments that will be delivered in the market will offer investable stock.

- Student housing investment registered the highest increase last year, by over 250% reflecting the shift towards alternative sectors, although in absolute terms the volume was just about €2.8bn. There is certainly a rising investor demand for residential sectors that should offer income stability even at a cyclical downturn, but

40%

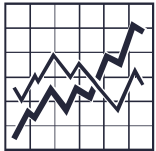
The share of investment into the office sector in 2019. We expect another strong year for offices as new developments will come as investable product on to the market.



The average prime multifamily yield in the 10 markets that we monitor was at 3.2% at the end of last year.



We forecast an average annual yield compression of 12 bps for prime offices by the end of the year.



We forecast the average shopping centre prime yield to move out again this year, from 4.98% to 5.12%.



In 2020 we predict that prime office rents will grow fastest in Lisbon (11.4%), Munich (9.6%) and Luxembourg (6.4%).



We predict that the UK transaction volume will recover by 12% in 2020.

lack of income producing assets is restricting activity, hence multifamily investment dropped by 21% last year.

- Demand for alternatives is also driven by the search for yield. The student housing sector offers overall a positive yield spread over prime offices at 89bps on average. It can be as high as 215 bps in the Netherlands and can as low as 35 bps in Norway. Demand for student housing will remain strong this year and we will see more investors partnering with local developers and international operators to access stock.

- Multifamily has generally become quite expensive due to the competition for prime stock and in many cases yields are even lower than offices. Strong housing demand and supply imbalances in most big cities have fuelled investor interest, however affordability is becoming an issue and regulations on rents are becoming tighter. The average prime multifamily yield in the ten markets that we monitor was at 3.2% at the end of last year.

- European hotel investment totalled approximately €22.6bn in 2019, 0.4% higher yoy. The average prime yield for leased hotels was at 4.27% at the end of 2019, 49bps above the average prime CBD office yield.

- Finally looking at the “omni-channel” sector, for another year

we observed the drop of retail investment (-13% yoy) and the rise of logistics investment (6% yoy). Five years ago, the total retail investment volume was at €67.2bn and the total industrial was at €23.3bn. Last year the gap narrowed with €40.9bn invested into retail and €36.6 into logistics and they are likely to converge even further in 2020.

- The widening gap of buyer and seller expectations around pricing in the retail sector will be restricting deal making, however price corrections are expected to emerge, creating an opportunity for value-add investments. Several retail properties in good locations, with strong catchment areas have the potential to be redeveloped, repositioned or completely converted into other uses. We expect the UK market to lead the trend.

- A number of investors have been looking in secondary cities for core plus and value add opportunities. Last year the average share of investment into capital cities dropped to 36% from 54% the year before. The UK, France and Spain were amongst the larger markets where we noted a shift towards the regions, in the UK they captured 64% of the activity last year, in Spain 61% and in France 31%.

### Transaction activity will be driven by “flight to quality”

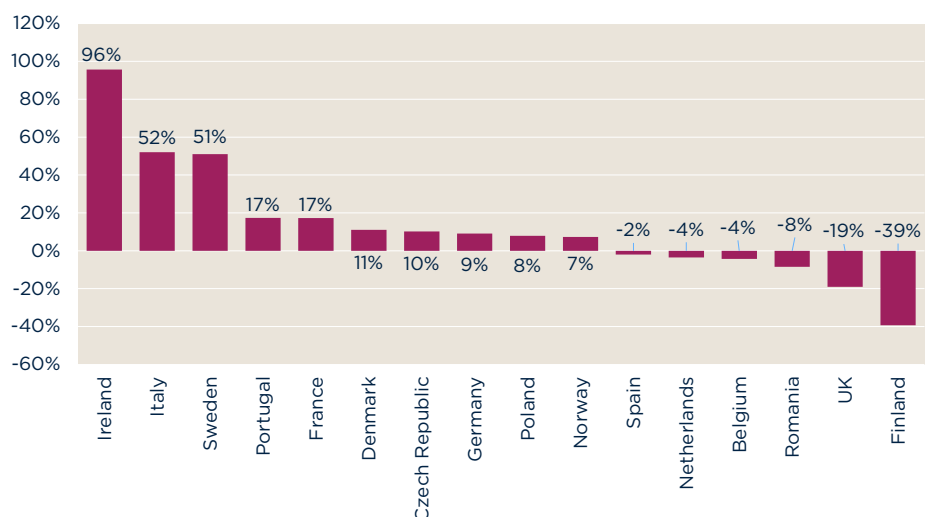
- Investor intentions remain positive for European real estate, supported by strong fundamentals, cheap debt and comparatively attractive yields. With the accommodative monetary policy lasting for at least another year, record low yields remain acceptable to investors. In fact, the prime office yield spread with the 10 year sovereign bond yield has been widening over the past two years (by 37bps) on average, making property look even more attractively priced.

- Already the first month of the year saw record high investment volumes in the German market. With a transaction volume of almost €5.7 bn, January 2020 was the strongest January for investment on record. The rolling twelve-month transaction volume stands at approx. €90.8bn, which is around 2% higher than December’s figure.

Some €2.7bn were invested in France in January 2020 against €1.8bn last year. Although it is too soon to say this sets the trend for the year. We expect a strong investment activity in 2020, fuelled by both domestic and cross border interest.

- It is still early to witness the impact of coronavirus on real estate, which is typically an asset

### European investment 2018-2019 changes highest in peripheral markets



“Strong flows of money into real estate will continue to push prices further up, faster than rents”

type that reacts with a lag to shocks. Nevertheless we expect the immediate impact to be on the one hand a delay in some transactions, especially cross border ones, due to travel limitations and on the other hand a “flight to quality” towards prime markets and assets, due to the risks that the spread of the coronavirus may pose on businesses and the economy. The most vulnerable segments are tourism, leisure and retail ie hotels, restaurants/cafes, malls. However, for now we have not revised our projections on pricing, as we expect activity to bounce back in the second half of the year, if the outbreak is successfully contained by summer.

• In that case we could witness another strong year of investment turnover, driven by the recovery in UK volumes and strong investor demand for the core markets.

#### Another year of hardening yields ahead

• The average prime CBD office yield in our survey area was at 3.9% at the end of 2019, 27.2 bps compared to 12 months before. We forecast that despite concerns about the strength of economic growth and other geopolitical risks, the strong flow of money into real estate will continue to push prices further up, faster than rents. We forecast an average annual compression by 11.6 bps by the end of the year. Budapest is projected to

experience the strongest yield compression by 40 basis points from 4.9% to 4.5%. We expect prime office yields in Germany to continue to compress by up to 30bps to 2.40% in some cases.

• The average logistics prime yield moved in by 40bps pa last year to 5.29% and we forecast to compress by another 10.6 bps this year to 5.19%. At the same time we forecast the average shopping centre prime yield to move out again this year, from 4.98% to 5.12%, bringing the retail and logistics yields in almost full convergence. The strongest yield compression in the logistics sector is forecast in Greece (-75 bps), Denmark (-50bps) and Netherlands (-35 bps). Denmark and Netherlands are also expected to register the highest level of yield softening in the shopping centre segment, by 125 bps and 100 bps respectively, reflecting the strong shift towards e-commerce. Both countries have just passed the inflection point of 10.7% penetration of internet sales, which from our UK market analysis, causes a rapid growth in occupier demand for logistics space.

#### Prime rental growth outlook is positive for investors

• The main question for the coming years is to identify the markets with positive rental growth outlook. According to Capital Economics

predictions prime office rents will continue to rise over the next five years, as demand and supply imbalances for good quality offices are expected to persist. Last year the annual delivery of new office space was up 7.5% compared to 2018 and equivalent to about one third of the annual take up. The development pipeline for the next 24 months in a number of key markets is estimated to deliver about 90% of 2019 take-up, when the average vacancy rate has dropped to 5.4% at the end of last year.

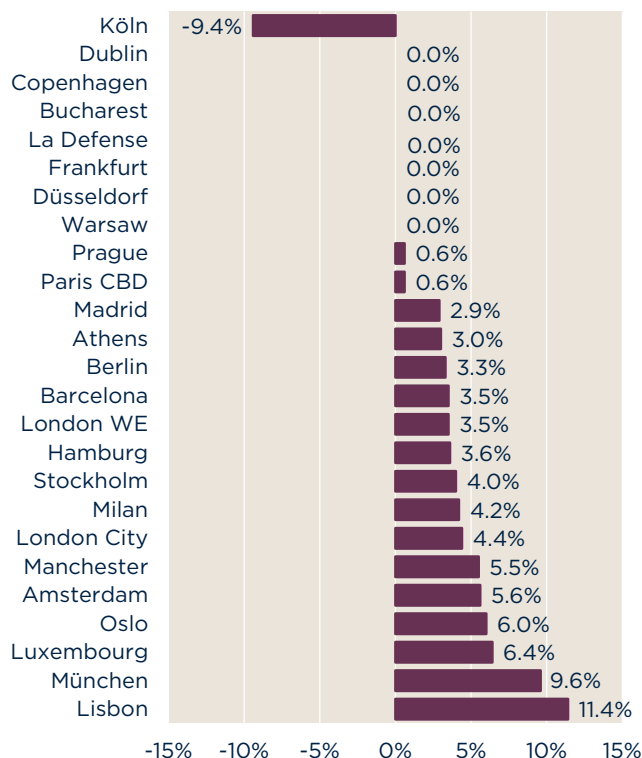
• According to our in house forecasts the markets with the higher rental growth prospects over the next five years are London City (3.4% pa), Stockholm (3.0% pa) and Madrid (2.7% pa). In 2020 we predict that prime office rents will grow fastest in Lisbon (11.4%), Munich (9.6%) and Luxembourg (6.4%).

• According to Capital Economics positive but slower rental growth is projected for the industrial sector, an average of 1.5% pa over the next five years, with Poland, Czech Republic and Hungary expected to achieve above average rates. Much more muted are rental growth prospects for the retail sector, where prime rents are expected to remain broadly stable, so in real terms they will weaken.

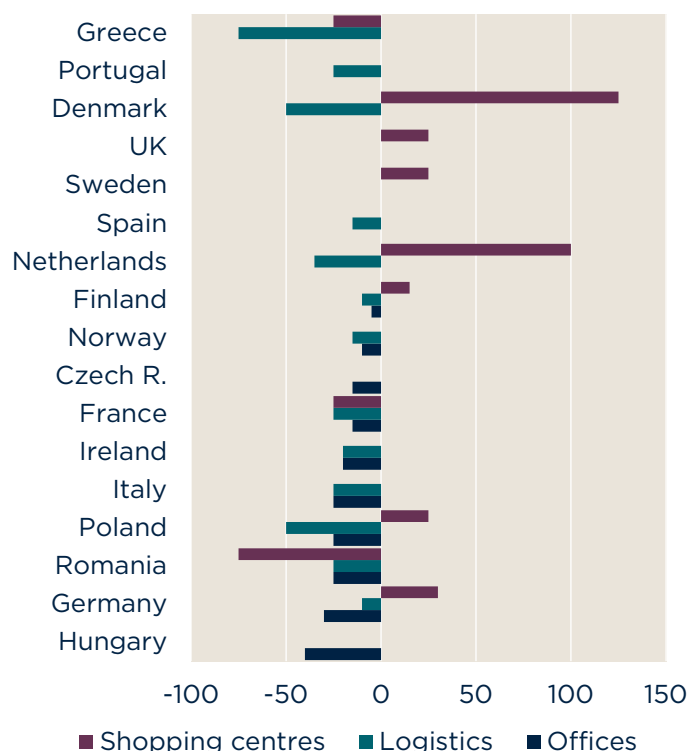
#### European prime office rental growth forecasts 2020

some non-core cities will see strong growth

#### Prime yield shift forecast 2020 by sector further yield compression for offices and logistics



Source Savills Research



Source Savills Research





---

### **Savills Commercial Research**

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

---

#### **Research**

##### **Eri Mitsostergiou**

Commercial

+30 (0) 694 650 0104

[emitso@savills.com](mailto:emitso@savills.com)

##### **Lydia Brissy**

Commercial

+33 (0) 624 623 644

[lbrissy@savills.fr](mailto:lbrissy@savills.fr)

##### **Mike Barnes**

Commercial

+44 (0) 207 075 2864

[mike.barnes@savills.com](mailto:mike.barnes@savills.com)

#### **European Investment**

##### **Marcus Lemli**

Head of investment Europe

+49 69 273 000 11

[mlemli@savills.de](mailto:mlemli@savills.de)