SPOTLIGHT
Savills Research

European Investment Outlook

savills

Photo by AbsolutVision on Unsplash

End-year projections ● Sector by sector analysis ● Yields movements

EUROPEAN ECONOMY - NOT AS BAD AS EXPECTED

According to Focus Economics, eurozone GDP in Q4 2020 declined by 0.6% QoQ, confirming that the autumn lockdowns had a less severe impact on the economy than in Q2 2020. As a result, the eurozone economy contracted by 5.0% YoY last year, with a wide degree of variation between countries. Germany and Spain expanded while others contracted. Austria was the worst performer by far, with a quarterly contraction of 4.3%, followed by Italy and France.

2021 will look to consolidate some of the economic losses observed during 2020, with eurozone GDP growth anticipated to grow by 4% during 2021. However, most European economies will not fully recover their economic losses until the end of 2022, except Ireland, the Netherlands, Luxembourg, Finland and Norway that are likely to recover earlier.

In Q4 2020, eurozone jobs increased by 0.3% QoQ, with over half a million jobs created despite pandemic restrictions. This suggests that government job protection schemes were successful in cushioning the blow to the labour market. In 2021, a surge in unemployment seems unlikely. Most European governments are choosing to extend their job support schemes and will probably scale them back only gradually with the end of lockdown restrictions.

Inflation is expected to rise slightly on the back of the last year's plunge in oil prices; however, it will remain below the ECB target. As a result, the ECB is likely to continue net asset purchases under its Pandemic Emergency Purchase Programme (PEPP) until December 2022. The Bank is likely to leave the deposit rate unchanged at -0.5%.

2021 end-year volume expected to range between €250bn and €280bn

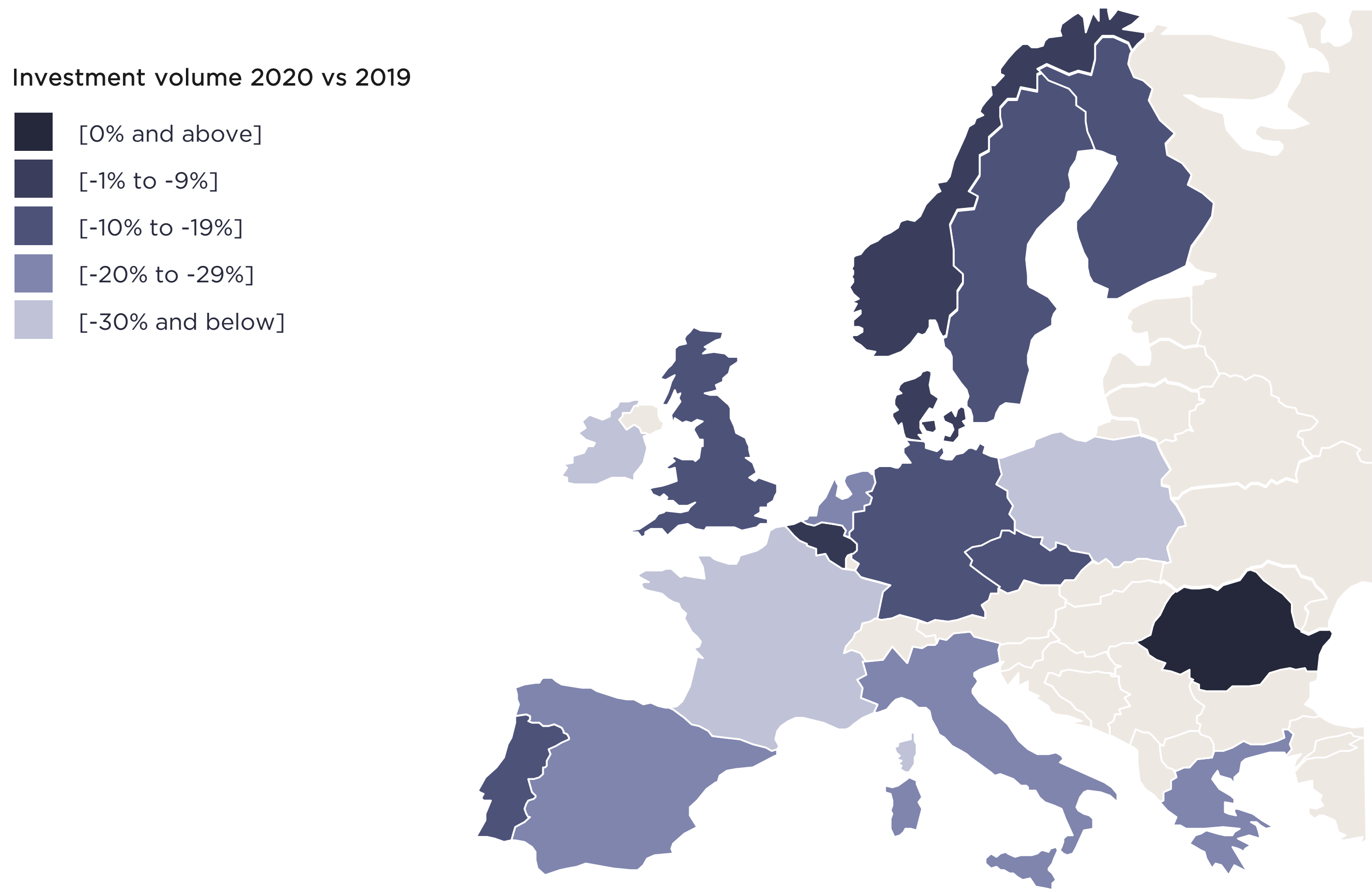
European commercial and residential investment volumes reached approximately €258.3bn in 2020, marking a 17.8% drop compared to 2019 and an 8.3% decrease on the past five-year average. Investment activity slowly picked up since Q3, yet in the final quarter of the year, which totalled approximately €81.7bn, it remained 12% down on the average past five-year Q4.

Romania and Belgium are the only countries where investment volumes increased annually (+32.3% and +9.3% respectively). In Romania, the strong annual increase is on the back of a relatively weak investment year in 2019, when in all other European countries, investment results were high, up to record highs in some cases. Compared to the average past five-year investment turnovers, Belgium (+22.5%), Portugal (+12.2%), and Sweden (+11.1%) were the most resilient countries. In the case of Belgium and Portugal, this was thanks to a particularly strong Q1. Whereas in Sweden, investment volume rocketed to a new high (€7.5bn) during the last quarter of 2020. The same story goes for Denmark, where investment volume reached €4.6bn in Q4 2020. As a result, last year, investment in the Nordics accounted for 17% of the total, against 15% in 2019. The share of core countries also increased from 62% in 2019 to 63% last year, supported by robust levels of activity in Germany. This is confirming investors' cautious targets toward low-risk and liquid markets.

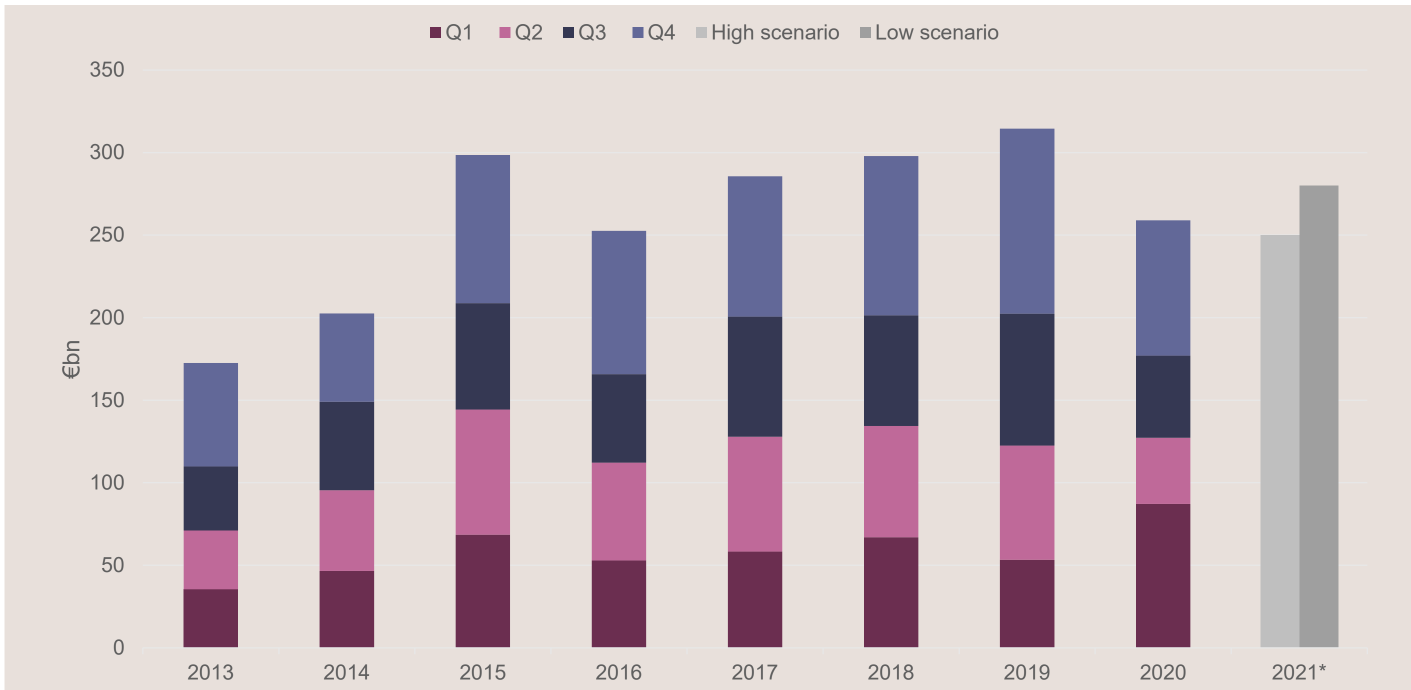
As expected, due to lockdown restrictions, the volume of non-domestic capital reaching the European real estate market decreased. Last year, cross border investment accounted for 42.3% of the total volume compared to 47% in 2019. During the final quarter, this share fell to 37.5%. Nevertheless, in recent months, we have seen increasing activity from investment managers and a rising number of joint venture acquisitions or entity deals, enabling international funds to invest abroad.

In 2021, we expect investor demand for real estate to remain firm, driven by higher returns compared to other asset classes. Typically in periods of uncertainty, there will be a focus on core assets and competition for the limited assets on the market will sustain low yield levels.

We expect to witness further diversification towards alternative asset types, which are increasingly becoming mainstream (e.g. living sectors, datacentres, science parks). The rising importance of ESG strategies will favour assets with green credentials and social value (green buildings, mixed-use, social housing). Investors with higher risk appetite will shift towards value-add opportunities in order to achieve higher returns (development, distressed opportunities). Given the current state of the pandemic, we expect first-half volumes to be constrained and activity to pick up in the second half. European investors should again be the main protagonists, while cross border players who operate via European management platforms will also have a competitive advantage, given the ongoing travel restrictions. All in all, we expected the European end-year volume to range between €250bn and €280bn (-3% and +9% compared to last year).



European investment volumes



Source: Savills Research / * Forecast

Beds and sheds best performing assets

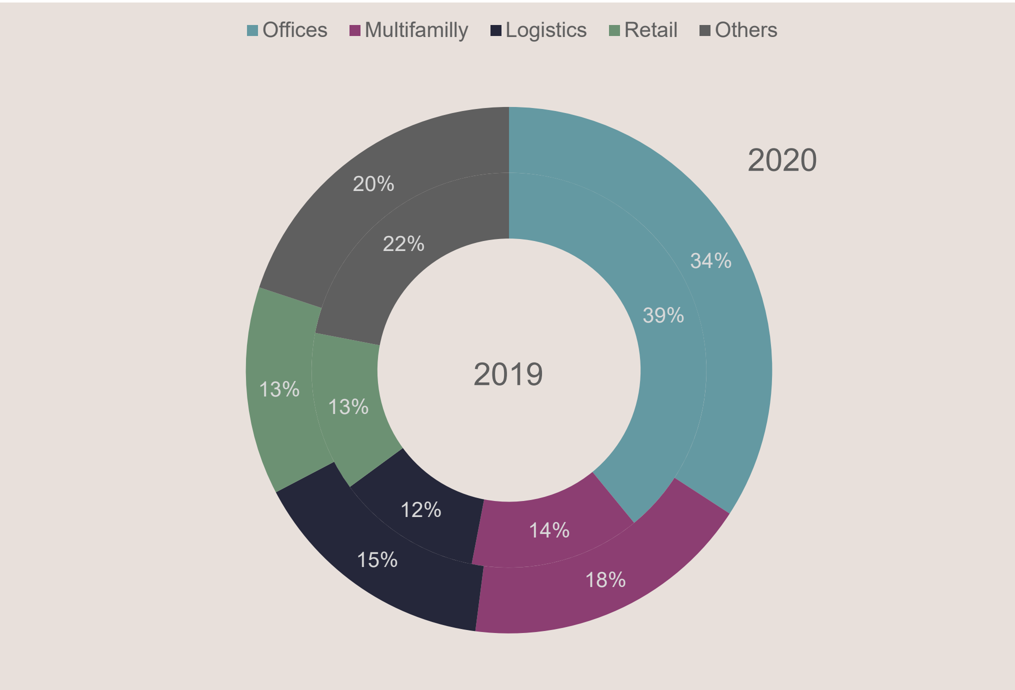
The pandemic has triggered behavioural changes creating uncertainty about the future of occupational demand for certain types of assets. Multifamily has proven to be the most resilient sector during 2020, representing a 4.7% increase YoY to €46.3bn and remains the second most active sector, accounting for 18% of the total volume. Germany was once again the largest recipient of multifamily investment, accounting for 42.2% of the European total, followed by Sweden (12.3%), Netherland (12.2%), Denmark (9.2%) and Spain (5.9%).

Investment demand for European logistics soared to €39.6bn, marking a record year of transaction volumes, up 5% YoY and 13.9% above the past five-year average. The UK (€10.9bn), Germany (€6.6bn), the Netherlands (€4.5bn) and France (€4.2bn) accounted for the majority of investment transactions as both domestic and cross border buyers opted for core markets. However, Poland (€2.6bn, +65.4%), Belgium (€0.6bn, +63.2%) Finland (€0.6bn, +33.3%) and Netherlands (€4.3bn, +31.8%) stood out as the markets which outperformed most significantly against 2019.

Although offices remained the predominant asset class, the share of office investment has fallen from 39% to 34% between 2019 and 2020. Last year, office investment volumes fell by 28.5% YoyYto €88.6bn. Core countries accounted for 68.4% of this amount, with Germany (28.2%) the main recipient, followed by France (20.9%) and the UK (16.4%). Belgium (+56.2%), Romania (+50.6%), and Portugal (+19.3%) are the only countries where office investment increased last year compared to the five-year average.

Retail investment fell by 20.3% YoY to €33.1bn. The share of retail dropped to 13% of the total real estate investment, compared to a five-year average of 18%. Germany accounted for 36.2% of the activity, the UK for 15% and France for 13.3%. It is worth noting that activity recorded in Sweden (+59.7%), Spain (37.2%), Portugal (22.4%) and Denmark (+5.5%) exceeded 2019's levels. Investment volume in the sector was underpinned by investor demand for food and convenience retail (supermarket portfolios, retail warehouses). The supply of product has been driven by investors who are aiming to reduce their exposure to the retail sector and owner-occupiers who are trying to raise capital through sales and leasebacks.

Investment breakdown per asset class



Source: Savills Research

Yield gaps: mixed picture between convergence and divergence

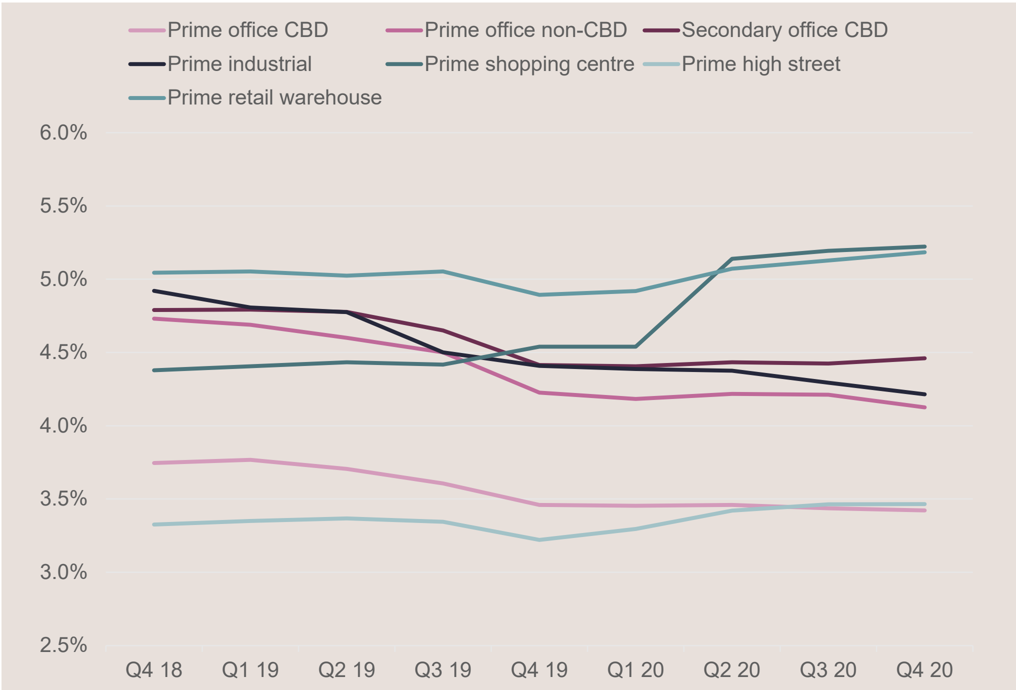
European average prime office CBD yields further moved in by 4bps annually to 3.57%, ranging from 2.7% in Munich and Frankfurt to 7% in Bucharest. Prime office yields have compressed across Oslo (-40 bps), Milan (-25bps), London WE (-25bps), Copenhagen (-25bps), Paris CBD (-15bps), Frankfurt (-10 bps) and Hamburg (-10bps). At the other end of the spectrum, Manchester (+25bps), La Défense (+25bps), Athens (+25bps), Prague (+20bps) and Helsinki (+15bps) moved outwards. Overall across Europe, we expect prime office CBD yield to remain stable in 2021.

The divergence in yield movement between prime and secondary yields is further widening. The average secondary CBD office yield moved out by 6bps between 2019 and 2020 to 4.43%. London WE and London City (+25bps), Manchester (+25bps), Helsinki (+30 bps), Amsterdam (+20bps) and Frankfurt (+10bps) secondary offices all moved out, although Copenhagen (-25bps), Oslo (-20bps) and Munich (-10 bps) compressed. Investors are demonstrating additional caution due to the heightened financing, occupational and liquidity risks across secondary offices. We expect the yield gap between prime and secondary office assets to diverge more significantly this year.

Resilient demand for core logistics product observed downwards pressure on prime yields in the final quarter of 2020, compressing by an average of 13 bps. Ireland (-50bps to 4.25%), and France (-25bps to 4.00%) compressed the most in the final quarter of 2020. It should be noted that Berlin prime logistics yields have traded in the 3% region, although the rest of the German prime markets are trading in the 3.6 to 3.7% range. Given the allocation of real estate capital targeting the logistics sector, we anticipate further yield compression as buyers are increasingly willing to take on more vacancy risk.

Intense competition has been pushing multifamily yields down rapidly over the past few years. The average prime multifamily yield has compressed by 120 bps since 2012 to reach a record low of 3.24% in 2020. Prime net multifamily yields range from 2.4% in Berlin to 5% in Warsaw, although in their majority markets command prime net yields of 3.0% to 3.5%. Despite the fact that multifamily has become an expensive asset class, the yield spread over the risk-free rate

Average European yields



Source: Savills Research

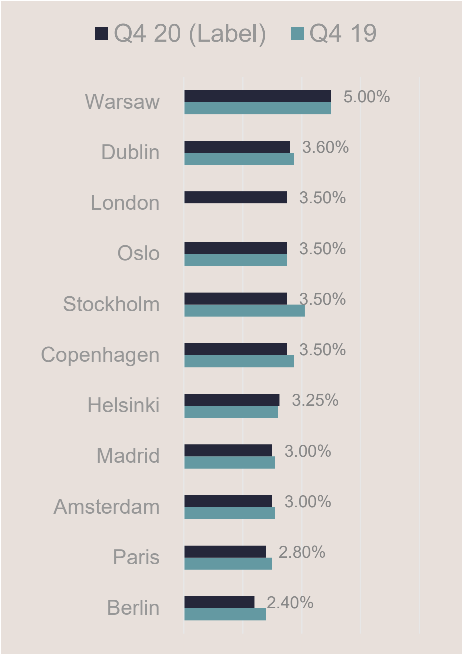
remains attractive and currently stands at about 294bps versus a long-term average of 247bps.

The shopping centre was the most affected retail segment, with the prime European average yields at 5.25% in Q4 2020, which is 57bps above the previous year's level and 4bps above Q3 2020. Prime shopping centre yields moved out annually in almost all markets, except in Paris and Bucharest where, it remained stable. The most significant yield softening was recorded in London and Dublin (+125bps). In London, the prime shopping centre yield, currently at 7%, has become one of the highest across all European cities we monitor, in line with Athens.

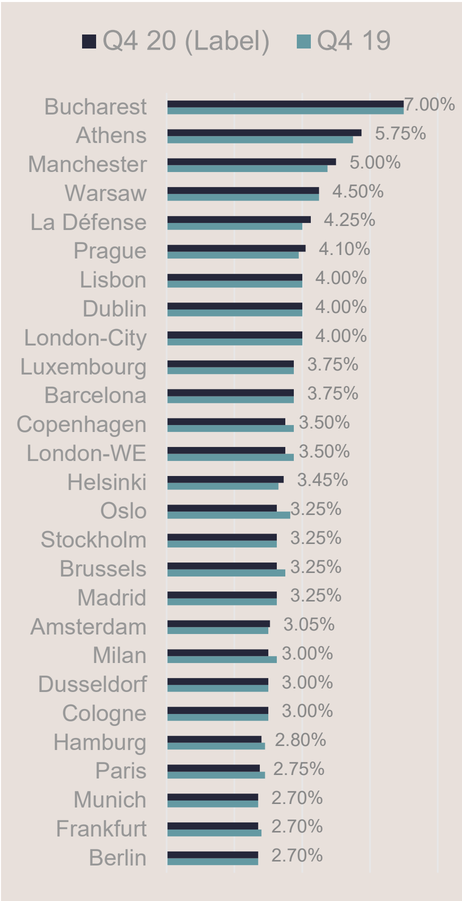
Prime retail warehouse yields have moved out by 27bps YoY on average across Europe and by 5bps QoQ to 5.2% in the final quarter of 2020. The most significant annual yield softening was noted in Dublin (+100bps), Paris and Amsterdam (+50bps). Oslo is the only city where the prime retail warehouse yield moved in by 25bps YoY.

In the same vein, the European average prime high street yield moved out by 24bps YoY and remained stable between the third and last quarter of last year. In London, the major German cities, Stockholm and Helsinki, it remained stable both on an annual and quarterly base. Dublin and Lisbon recorded the steepest outward yield movement (+75bps YoY), followed by Helsinki (+65bps YoY).

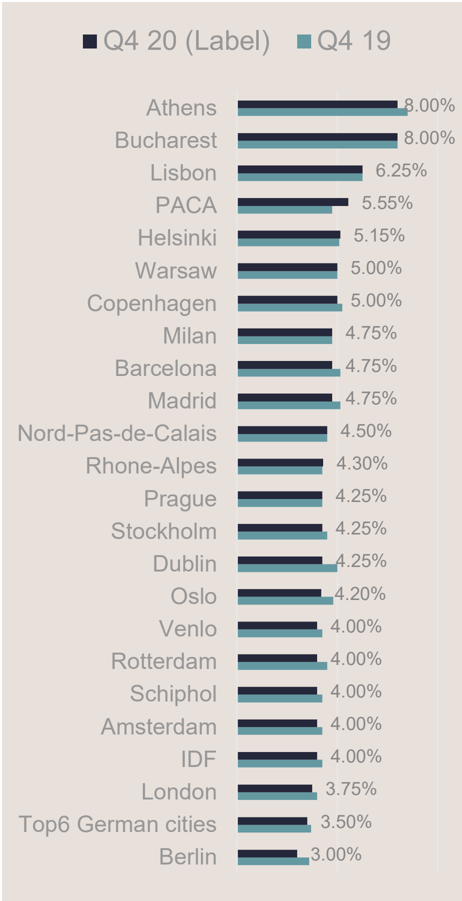
Prime multifamily yields



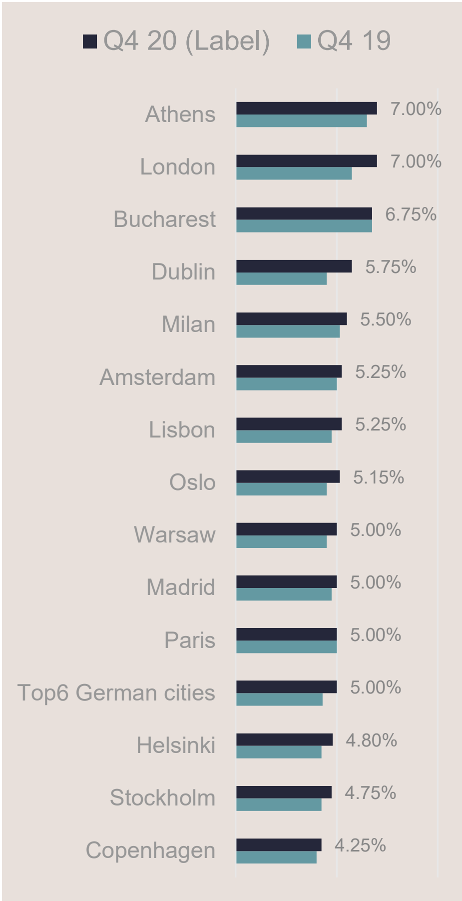
Prime office CBD yields



Prime logistics yields



Prime shopping centre yields



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.

Oliver Fraser-Looen
Regional Investment Advisory | EMEA
+44 (0) 20 7409 8784
oflooen@savills.com

Tristam Larder
Regional Investment Advisory | EMEA
+44 (0)20 7409 8014
tjlarder@savills.com

Lydia Brissy
Europe Research
+33 (0) 624 623 644
lbrissy@savills.com