

European Multifamily

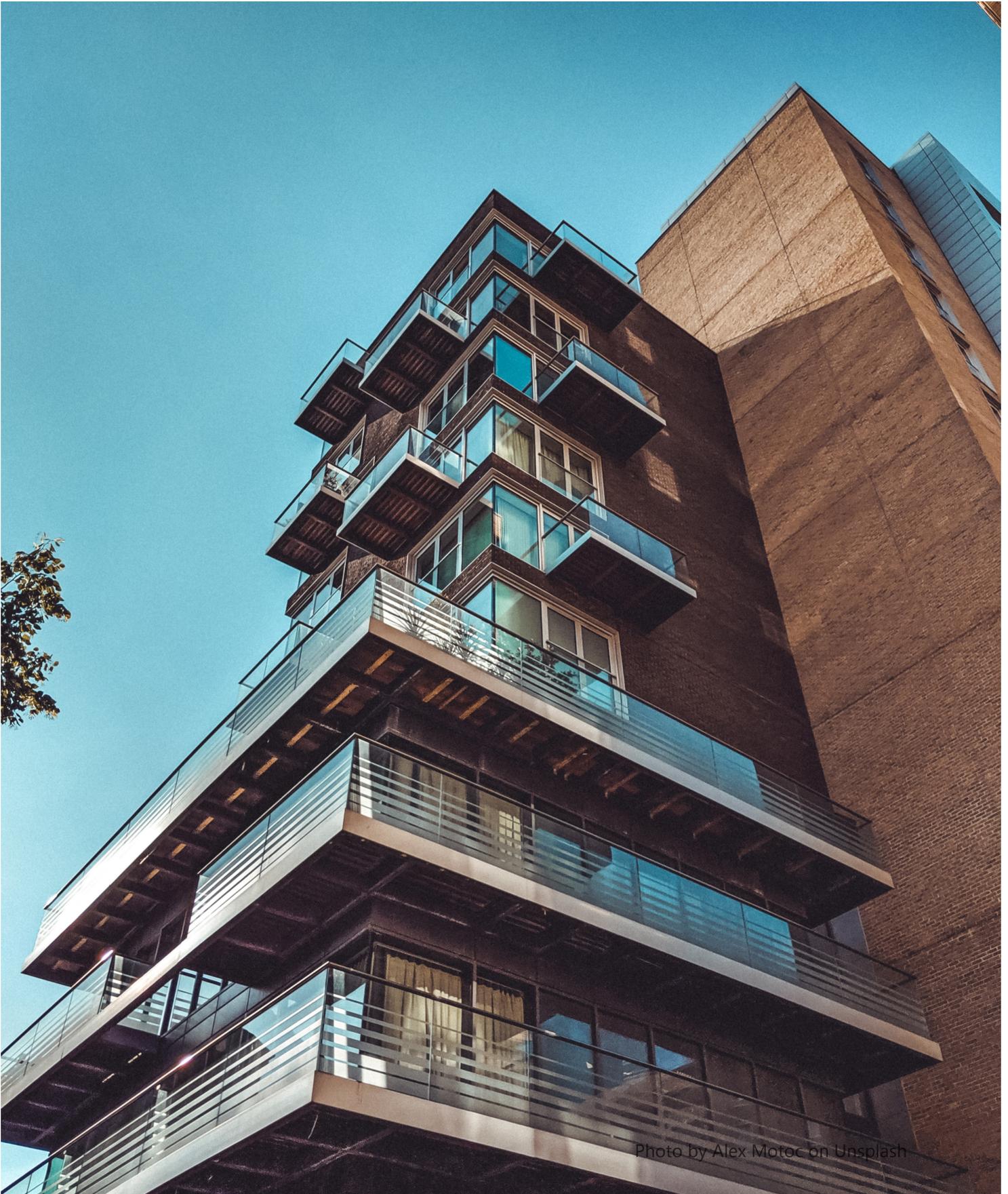


Photo by Alex Motoc on Unsplash

“Housing is a basic need and therefore rent collection rates have remained higher compared to other property sectors during the pandemic.”

Multifamily investment on the rise

Multifamily has proven to be the most resilient sector during 2020, representing a 6% increase YoY and a 17% increase on the past five-year average

Multifamily becomes a core asset type

- European commercial and residential investment volumes reached approximately €257bn in 2020, marking an 18% decrease in 2019 and an 8.5% decrease on the past five-year average. Multifamily was the second most active sector last year at €46bn, capturing part of the capital, which has been diversifying away from traditional real estate sectors, such as offices and retail.
- The pandemic has triggered behavioural changes creating uncertainty about the future of occupational demand for certain types of assets. Last year the share of office investment has fallen from 39% in 2019 to 34%, as we observed proportional increases in logistics (from 12% to 15%) and multifamily (14% to 18%). The share of multifamily was as high as 53% of the total in Denmark, 39% in the Netherlands, 28% in Sweden and 18% in Finland, which are markets where the sector has been established for a number of years. Shares were also exceptionally high in smaller markets where the sector is maturing rapidly, such as 50% in the Czech Republic (due to a major portfolio transaction), 39% in Ireland and 29% in Spain.
- Germany was once again the largest market in 2020. It captured 40% of the

activity, followed by the Netherlands at 15%, Sweden at 12%, Denmark at 9%, the UK and Spain at 6% each. The markets that captured notably higher shares in 2020 compared to the year before were the UK, France and Denmark.

Multifamily yields at record low levels

- Intense competition has been pushing yields down over the past few years. The average prime multifamily yield has compressed by 120 basis points (bps) since 2012 to reach a record low of 3.24% in 2020. Prime net multifamily yields range from 2.4% in Berlin to 5.0% 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 remains attractive and currently stands at about 294 bps versus a long term average of 247 bps.

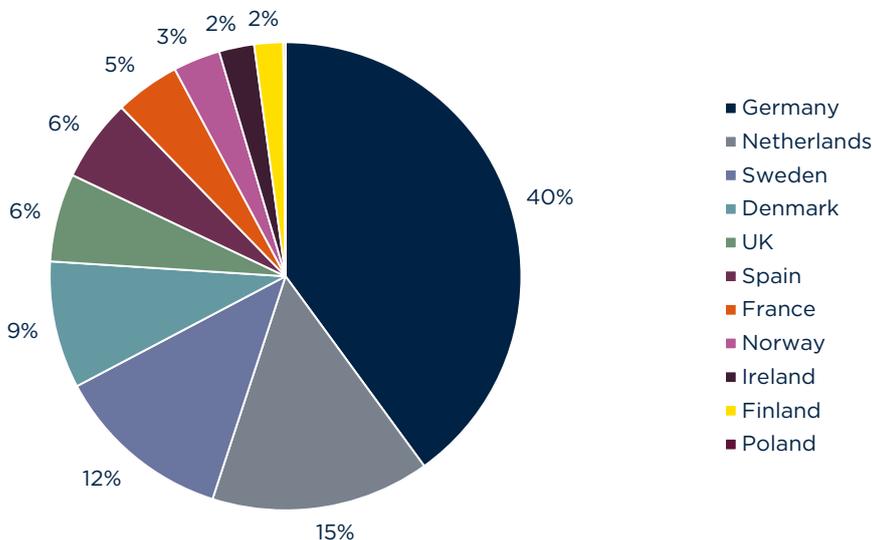
Outlook - Multifamily is moving from alternatives to core

- Restrictions and delays in construction activity over the past year may further intensify the demand and supply imbalance of professionally managed multifamily stock

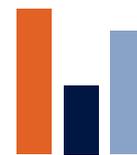
in the major European cities. Competition for income-producing assets is expected to be strong and prices may rise further, especially in markets where rental housing supply lags demand.

- Economic uncertainty is likely to intensify demand for rental, but rental growth prospects may be muted, until household confidence recovers. Nevertheless, residential income streams are hedged against inflation in most markets, offering stable and resilient income streams.
- Due to the defensive characteristics of the sector, we expect banks to remain an active capital source for the sector, supporting development activity. We believe that this year we will also see more investors getting involved in the production of new stock.
- The entry of new market players in the sector will underpin transaction activity and establish multifamily as one of the top asset types of choice for property investors in Europe.

European multifamily investment 2020 by country



Source: Savills Research



294bps is the yield spread of prime multifamily over the average risk-free rate in Europe

18%

The share of multifamily investment in 2020. The highest shares were seen in Denmark (53%) and the Czech Republic (50%) due to portfolio transactions.



Multifamily was the second most active sector last year at €46bn.



Multifamily has proven to be the most resilient sector during 2020, representing a 6% increase YoY.



Germany was once again the largest market in 2020 capturing 41% of the activity.

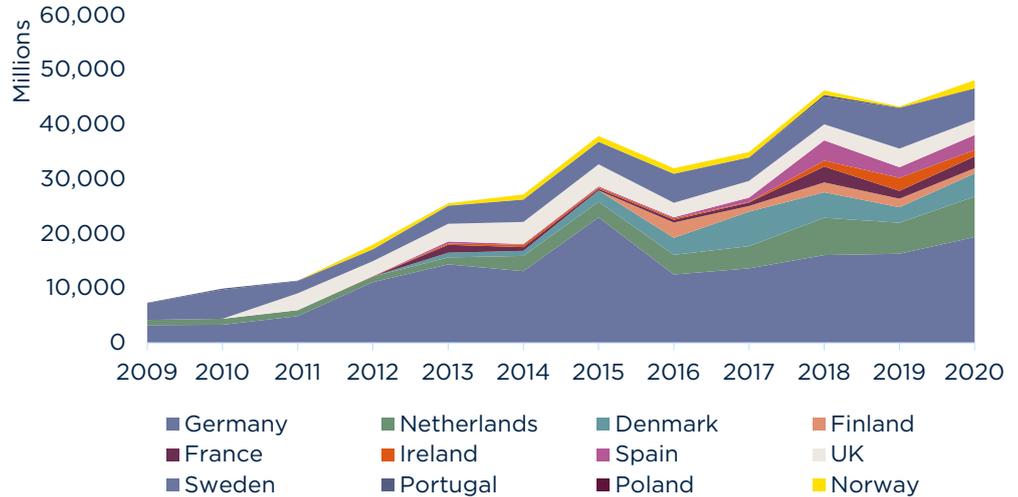


The average prime multifamily yield has compressed by 120 bps since 2012 to reach a record low of 3.24% in 2020.



Residential rent collection rates were above 80% on average across the key markets.

European multifamily investment (Euro)



Source: Savills Research

Fundamentals and post-Covid considerations

The pandemic is having an impact on people’s housing choices, but the fundamentals of the sector remain strong

Drivers of demand for rental housing

The minimal impact of the health crisis on investor appetite for multifamily is supported by the strong fundamentals and the defensive characteristics of the sector. Housing is a basic need and rent collection rates have remained higher compared to other property sectors during the pandemic. Additionally, demand for rental is rising in periods of economic uncertainty, as people feel less secure about their future finances and mortgage lending for house buyers becomes more strict.

One of the key factors that has been driving demand for rental is the steep rise in house prices across Europe over the past years. Average house prices have increased faster than average incomes since 2015, across the markets we monitor. The highest gap between house price and household income growth (over 110 ratio) is noted in the Netherlands, Germany, Spain, Austria and Ireland.

This has led to an increase of rental ratios. The markets with the highest rise in rental rates since 2010 are Spain, Denmark

and Ireland, while the markets where over 35% of the population is renting are Germany, Austria, Denmark, Sweden, France and the UK. Most of the capital cities in these markets are experiencing strong urbanization trends. Over the next five years, we’re going to see 5% or higher household growth in cities like Stockholm, Copenhagen and Helsinki.

In many places, the rising need for rental homes cannot be met by the current rate of supply.

In Germany the current supply of residential units is lower than the existing number of households in most of the larger cities, which has created a demand and supply imbalance and an upward pressure in rents. However, at the same time, certain areas have become unaffordable for lower-income households and recently some negative migration towards cheaper, suburban locations has been observed.

In the Netherlands, we estimate a housing shortage of 200,000 homes by 2030. Developments in the mid-segment of the market, where there is most of the demand, are lagging. This is the result of strict

regulations, which are blocking the market progression putting upward pressure on rents.

In Spain, there is on average about 90,000 new households entering the rental housing market every year. For the time being, this demand is met by stock initially intended for sale.

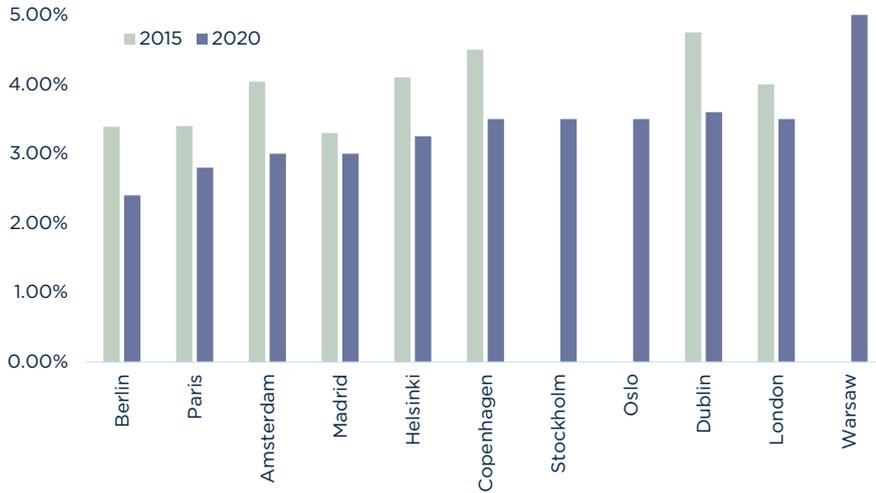
The rapid population growth in Copenhagen has pushed vacancy rates down to around 5% and has put a strain on affordable housing.

Post-Covid considerations: Wellness, sustainability and affordability

The health crisis is having an impact on the type of housing that occupiers are looking for. Some demographic groups, especially families, are in search of town houses in well-connected fringe and suburban locations that offer outdoor space and good access to amenities. On the other hand, younger generations may still choose to live in apartments in downtown, mixed-use locations, especially in walkable/cyclable cities with well-designed public spaces.

Wellness and work-life balance

Prime multifamily yields (net)



Source: Savills Research

are becoming a priority across occupier types. Cities will have to address some long-standing issues, such as affordability, mobility and access to green spaces. In order to reverse the suburbanisation trend, cities need to ensure that they remain desirable places to live in a post-pandemic era. Local authorities need to introduce policies that will enhance their liveability and long-term resilience.

There are already some examples of city administrations that are taking the lead on this. Paris and Milan are working towards the aim of becoming 15-minute cities, with a reduction of dependency on the use of cars, the introduction of longer bike lane routes and redesigning of public space. Barcelona is aiming to convert over the next decade its central grid into a pedestrian-friendly, greener area with limited car use.

At a building level, there will be more focus on outdoor areas, additional workspace for agile working, access to amenities and green space. Ensuring residents' wellness will require better design of apartments and communal areas and additional features such as on-demand services, systems which ensure good communication between

building managers, residents and neighbours, clean-tech solutions that focus on energy conservation and sustainability and green transport options. Taking into consideration all income levels and providing solutions across demographic groups can create diverse, sustainable communities with long-term residents. These characteristics can improve the social value of the assets and enhance their ESG credentials.

Affordable housing as an investment proposition

Another post-Covid consideration is related to affordability. Given the negative impact of the pandemic on economy and employment, household incomes may come under pressure and their ability to pay higher rents will be limited. Assuming that the maximum households can spend on rent is 30% of their income, we can see how affordability varies across Europe. The imbalance of demand and supply and the strong growth of demand for rental has been pushing up rents over the past few years. In cities like Copenhagen, Amsterdam, Dublin and Paris, the average rent of a one-bedroom apartment already accounts for one third or more of the average household disposable income.

This implies that the need for more affordable housing is high, while the prospects for further rental growth are becoming limited. The current health crisis has demonstrated that cities that offer affordable and high-quality living, will be more competitive, resilient and attractive to people and businesses.

Historically, the provision of affordable housing has been the responsibility of the public sector or housing associations. However, given the pressures on cities' budgets, an investment gap in this market segment has been created. In some cities (Dublin, Amsterdam, Madrid), the public sector is working with investors and developers to deliver more affordable homes, particularly through offering surplus land holdings with long-term incentives. The development and investment industry is also starting to view affordable housing as a sector in which they can generate stable returns and make a positive social impact.

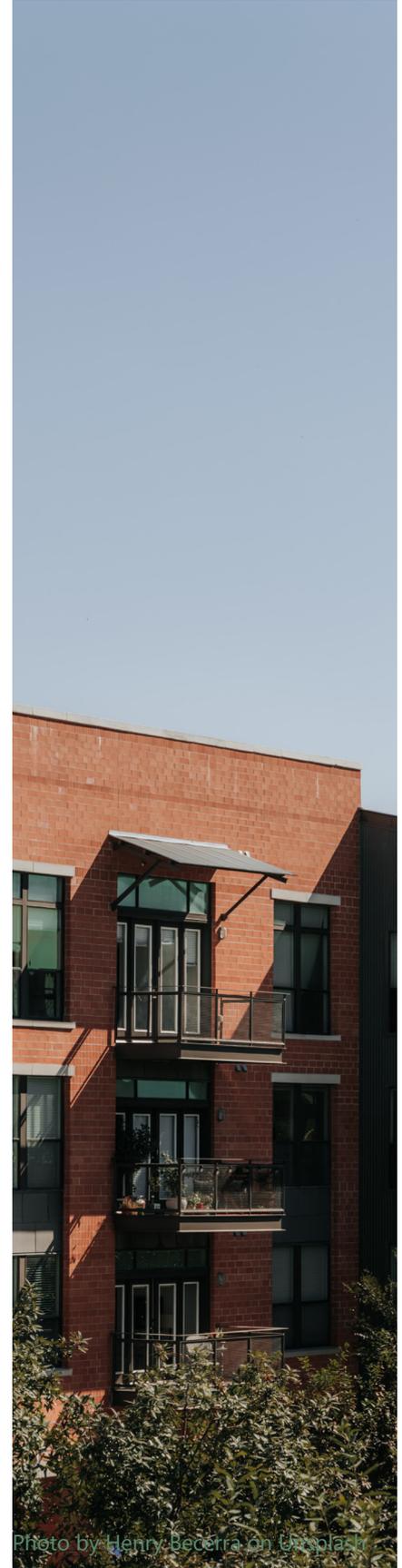


Photo by Henry Becerra on Unsplash

RENT REGULATIONS ARE BECOMING STRICTER

There are concerns that the rise of corporate investment in urban residential properties has a negative impact on housing affordability. Public authorities have introduced regulatory measures to protect tenants. However, these measures are often criticised for causing the adverse effect, as they deter new development activity. Measured rental growth controls, on the other hand, provide security to both tenants and investors who know what to expect. Currently, rent regulations are becoming stricter in cities like Paris, Berlin, Amsterdam and Copenhagen.

In most cities, there are stricter regulations for new leases signed in old buildings, while there is more flexibility in newly built homes or the ones that have been substantially renovated. The local comparable rent is a common benchmark and in most cases, it cannot be exceeded substantially. Regarding rent reviews, in most markets they are linked to inflation. In several markets, such as Denmark and Sweden, early entrants in the market have benefited from the reversionary potential of older properties. However, in their majority, investors are focusing on newly built assets or forward funding deals.

Summary of rent regulations of key European cities

	Berlin	Other German cities	Paris	Dublin	Amsterdam
Achievable rent (new leases)	Up to €9.80 per sq m for five years. Possible premiums of €1.00 for modern equipment and €1.00 for modernisation allocation.	Up to 10% higher than the local comparable rent. Newly built properties are exempted.	Rent has to match the level paid by the previous tenant. Energy-efficient buildings are exempted.	Rents must be set in reference to the local market. Newly built properties are exempted.	Regulated rent is based on “a point system” <750 €/month). Unregulated rents can be adjusted every year.
Rent reviews	Up to €9.80 per sq m for five years, no more than 20% above this level thereafter.	Rent increases up to the level of the local benchmark rent. Annual indexed-linked rental growth is also possible.	Indexation	Rents can be increased by a maximum of 4% per year.	Normally CPI + a % on household income based surplus. For 2021 the rents will not be indexed.
	Stockholm	Madrid	Barcelona	Copenhagen	Helsinki
Achievable rent (new leases)	Rent cannot exceed the level of comparable properties (existing stock). Rent for new buildings can be negotiated to cover costs + investor return.	Freely set - open market rent.	Determined by the Catalan Housing Agency’s Average Price Index.	Rent increases are not allowed for properties built before 1991 and for five years after renovation. Free market rent for properties built thereafter.	Freely set - open market rent (Government-subsidised ARA apartments excluded).
Rent reviews	Indexation	Indexation	Indexation	Indexation or fixed percentage	Indexation



Savills Commercial Research

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