European Investment – June 2020

SPOTLIGHT
Savills Research

European Multifamily

● European multifamily investment ● Covid-19 impact ● Outlook

> "Despite the overall slowdown in investment activity due to Covid-19, multifamily investment volumes in Q2 are expected to rise in half of the markets that we monitor"

Multifamily is becoming core

European multifamily investment activity is expected to remain strong in Q2 driven by investor confidence in the sector's fundamentals

Multifamily sector second largest after offices in some markets

• Multifamily investment activity in the first quarter of 2020 was close to €11.6bn in the 12 markets that we monitor, already 27% of last year's total, which was the second strongest year on record, at €43.2bn. Multifamily investment accounted for 18% of total activity. In Germany it was the largest sector, 1.1 times the office total. Germany was once again the largest market capturing 70% of the total with over €8.2bn of transactions, followed by the UK (€947m) and Sweden (€699m).

• Some of the largest transactions of operational assets were the sale of the Amber Portfolio to Heimstaden AB (€375m) in the Netherlands, the acquisition of Pioneer Point by Realstar and QuadReal Property Group (€112m) in the UK and early in the year the sale of the €1.3bn residential portfolio by Round Hill and Blackstone to Heimstaden in Czech Republic. Nevertheless, the majority of investors expanded their exposure in the sector through forward funding deals such as the acquisition of a 395 (142m) unit project and a 400 unit project (€110) in Madrid by Hines and Ares Capital respectively, the forward funding deal (€92m) by CPPIB/Lendlease of Elephant Park in London and Invesco's forward funding deal of Aubrey Place (€85m) in Milton Keynes.

• Despite the slowdown in investment activity during the second quarter, resulting from strict lockdown measures across Europe that aimed to control the spread of Covid-19, we anticipate at least another €10.3bn to have been deployed in the multifamily sector by the end of June, with half of the countries expected to achieve significantly higher volumes compared to the previous quarter.

• The average prime net yield has remained stable on a quarterly basis at 3.35% and 50bps below the prime office yield. Yields are stabilising in most markets, after a significant inward yield shift trend over the past five years. In Q1 2020 prime yields moved in only in Dublin from 3.75% to 3.6% . Prime achievable yields for newly built income producing assets are the highest in Warsaw (4.4%).

Impact on pricing has been minimal but rental growth expectations have to be postponed

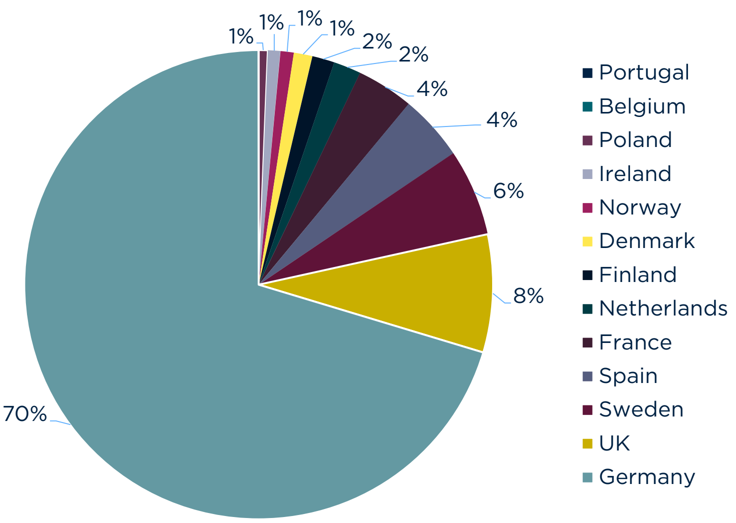
• The minimal impact of the health crisis on investor appetite for multifamily is supported by the strong fundamentals of the sector: rising urbanisation, smaller households, unaffordable house prices and rising occupier demand for flexibility and services. Additionally housing is a basic need and therefore demand for rental remains stable or even rises in periods of economic uncertainty. Supply of this type of product is low in most markets, and construction activity is restricted by high land values and construction costs, as well as limited labour availability.

• The main considerations for multifamily investors following the health crisis are expected to be around affordability and real rental growth prospects. Our data show that rent collection rates for residential portfolios in April were above 80% on average in our key markets. The ability of low income households to meet their rental obligations will be tested over the next few months as government support measures start phasing out. This will eliminate positive rental growth expectations for this year and next, while some moderate downward rent adjustments may also occur.

Outlook - Multifamily is moving from alternatives to core

• We expect investor interest in the

European multifamily investment Q1 2020 by country



Source: Savills Research

2.8% to 4.4%

Is the range of prime net achievable yields across the 12 markets that we monitor

18% The share of multifamily investment in Q1 2020. The highest shares were seen in Germany (33%) and Ireland (22%).

Close to €11.6bn worth of multifamily assets were transacted across Europe in Q1 2020

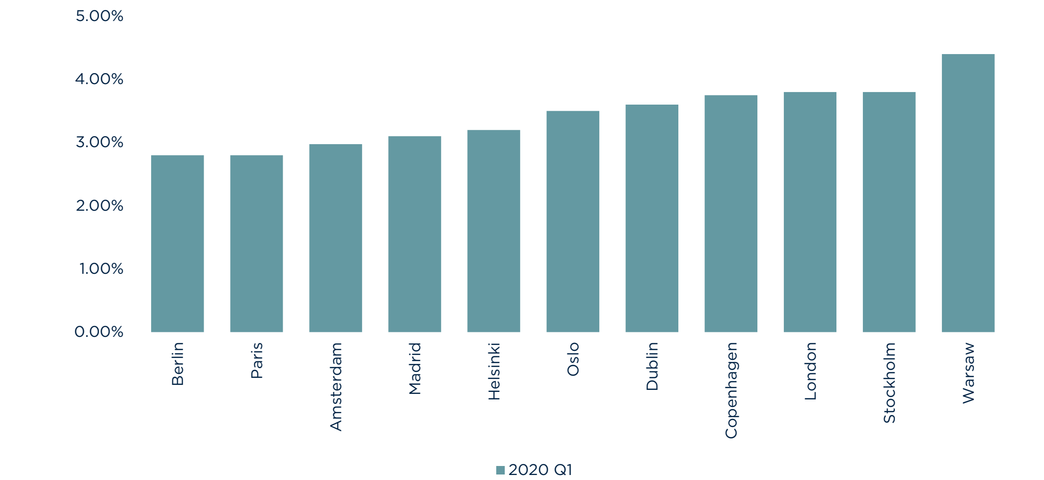
We anticipate multifamily investment in the second quarter to be at least around €10.3bn

In Q1 Germany was the largest market capturing 70% of the total volume

The average prime net yield remained stable in Q1 at 3.35%

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

Prime net multifamily yields for operational assets

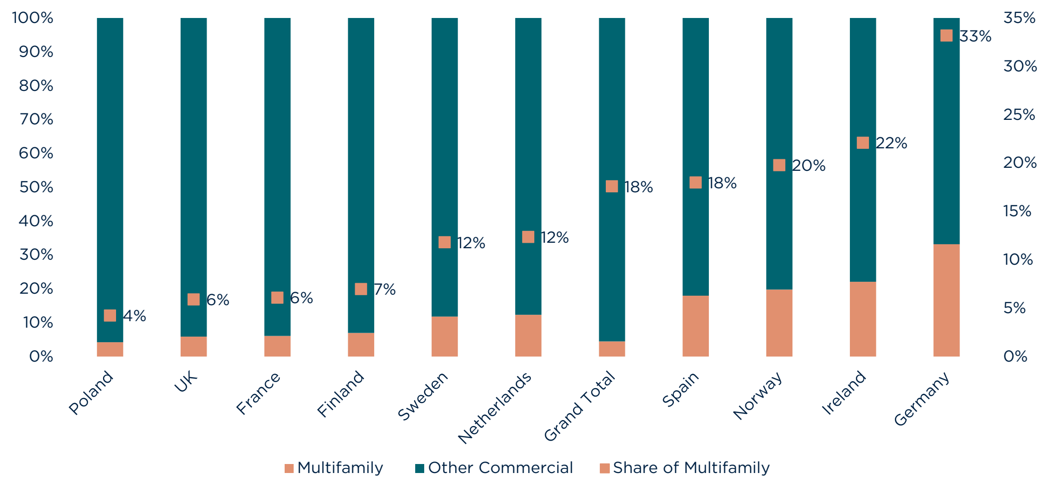


Source: Savills Research

multifamily sector to remain solid in the coming months. It is difficult to predict the levels of market activity in Q3 and Q4 and we may see some volatility, until there is a better understanding of how Covid-19 will affect our lives. However we believe that competition for the few prime located development sites or completed assets that are coming on the market will remain strong. The amount of capital targeting multifamily assets has remained unchanged since the beginning of the year and investor intentions indicate that more capital will be allocated to the residential sectors. Also lenders are seeing multifamily as a safe haven, because of rental income stability. Due to limited supply of operational assets, we expect most investment deals to be driven by forward funding development opportunities.

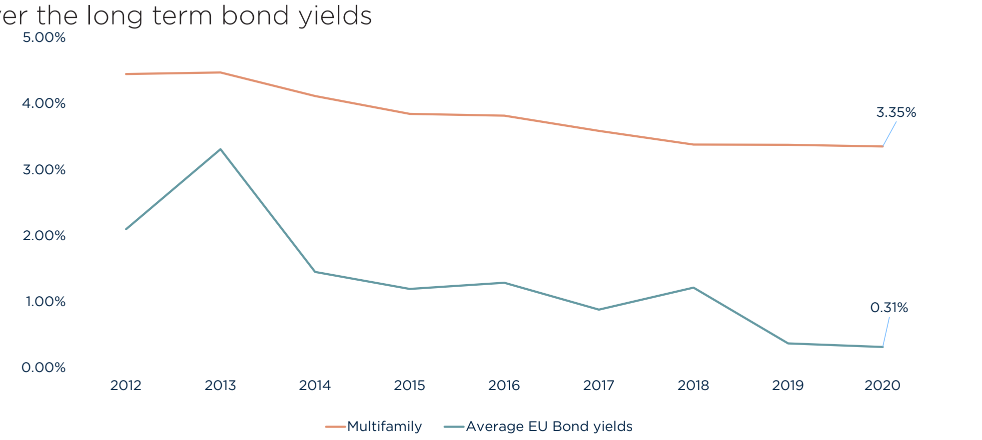
- From a pricing perspective, investors still have the same return requirements as they did at the start of the year. Where we are seeing an impact on pricing is therefore less about changing return requirements and more about a softening of underwriting assumptions as companies strategize on the rental levels and occupancy rates in a post-pandemic world of occupational real estate. Underwriting is also softening because of rising lending margins and more pessimistic rental growth assumptions. Investors are adjusting their expectations, focusing on medium income product, which can offer stable and sustainable income streams. We expect prime achievable yields to remain broadly unchanged until the end of the year and we observe price reductions of no more than 5-10%.
- Multifamily cannot be considered anymore an alternative investment. It has become an asset class suitable for core strategies, particularly in markets such as Germany, Netherlands and the Nordics, where volumes are comparable or even higher than offices. The sector is also maturing rapidly in Spain and Ireland where last year's volumes were two and five times higher compared to the five year average respectively.

Share of multifamily investment is becoming significant in some markets



Source: Savills Research

Average prime European multifamily yields offer an attractive yield spread over the long term bond yields



Source Savills Research, Focus Economics

Covid-19 implications on multifamily

The health crisis may iimpact the quality of demand

Despite the uncertain long-term implications of the health crisis, Covid-19 should not affect the fundamentals of demand and supply. Demand for multifamily should remain solid offering long-term, inflation hedged income streams to investors, especially institutional ones (pension funds, REITs etc) who are seeking these quality income streams.

Covid-19 has slowed down construction activity, which will intensify the shortage of housing supply in the short term. This means that the residential demand and supply imbalance that has been characterising the large European urban centres will continue to persist.

Shift to renting is expected to remain strong and even intensify due to the negative economic effects of Covid-19. Rising unemployment risks and tighter lending conditions, will make buying a house harder, especially for first time buyers.

Lower demand for home ownership and potential house-price slowdown is leading to a gradual shift of developer focus from BTS (Built-to-sell) to BTR (Built-to-rent) creating new investment opportunities even in traditionally owner-occupier markets, such as in Eastern and Southern Europe.

The main consideration for multifamily investors following the health crisis and the economic downturn that this is expected to cause, is affordability and real rental growth prospects. Rents are not expected to increase over the next 18 months in most locations.

Covid-19 may affect the quality of multifamily demand. Apartments in multifamily blocks in central areas may be less desirable in the short term and people might look to move in less densely populated areas. This could lead to some new investment and development multifamily opportunities in well-connected peripheral locations or secondary, satellite cities to major urban centres. But amenities, mix of uses and connectivity are expected to remain important.

Users may expect from multifamily apartments more private space, some outdoor space, storage or shared working areas when working “from home”, if they cannot afford an office space in their own apartments.

We also expect higher demand for community services and on-demand services in the managed rental sector and further price segmentation to meet the needs of different levels of affordability.

Overall we expect Covid-19 to accelerate changes in the housing market and create further diversification of product based on local demographics and economics. People have different needs and preferences depending on their personal status, income level, age and profession.

RENT REGULATIONS; DOUBLE-EDGED SWORD

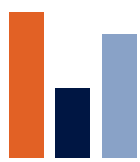
The shift of the population towards renting has been triggered by rising house prices. However, over the past five years rental values have also been rising fast, reaching unsustainable levels compared to what the average household can afford to pay. We could see rent regulations intensifying in the future as there is a burning need for affordable housing across highly urbanised cities.

Public authorities have introduced various degrees of regulatory measures with regards to upward rent reviews. In Berlin there is a rent freeze, in Dublin they cannot increase by more than 4% pa, in other German cities a local average is used as a benchmark, in Denmark there are limitations for properties built before 1991, while in Amsterdam developers have to provide at least 40% social housing.

All these measures are aiming to reduce speculation in a socially sensitive sector, where most governments are struggling to provide the level of social housing required.

Tight rent regulations that seek to protect tenants 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.

In Finland instead of restrictions, there is a comprehensive housing allowance system maintained by the state owned Kela (The Social Insurance Institution), while in Ireland and Portugal local authorities are shifting to social leasing agreements with developers.



75bps
lower on average were prime net yields in Q1 2020 compared to five years ago

Savills Commercial Research
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