MARKET IN MINUTES

Savills Research

European Investment

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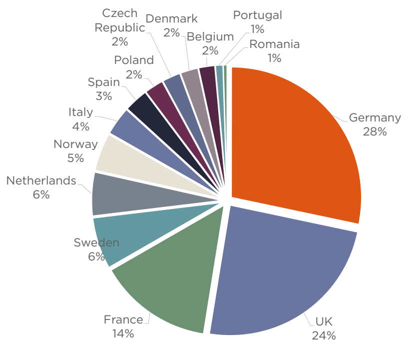
In search for higher returns - 5% plus opportunities

We are well into Q1 2019 and investor interest for prime real estate remains strong. Fewer opportunities seem to constrain activity, but prime yields have stabilised at historic low levels. The average prime yield for CBD offices stands at 3.7%, for shopping centres at 4.8% and for logistics warehouses at 5.4%. Prospects for further yield compression are becoming more limited but competition for core products will remain high. Low cost of finance and an attractive spread over long term government bond yields implies that no significant value shifts are expected

At the same time investors are feeling more cautious, as there is a growing concern that the global economy is entering a late cycle stage and they are less prepared to move up the risk curve. Searching for assets with strong fundamentals but higher returns has become more challenging, but we believe that Europe still offers attractive investment opportunities, especially in the Core+/Value add segment of the market.

Q1 2019 investment by country



Source Savills Research

Offices

Despite the weaker momentum of the European economy, economic forecasts remain positive with GDP growth projected at 1.8% this year, supported by a strong labour market, accommodative monetary policy and low inflation. This should support demand for office space for another year. Besides, office availability is at record low levels and the volume of completions may only cause a minimal rise this year. Most capitals in Europe suffer from undersupply of space in central locations in particular. As a result demand for quality offices in well-connected fringe locations is solid and rents are stable or rising. Core+/Value add opportunities of this type can be found in Stockholm, Copenhagen, Milan, Madrid, Barcelona, Oslo and Paris at yields between 5.25% and 6%, or higher for refurbishments and new developments. Yields may even exceed 6% for offices in secondary cities of the UK, the Netherlands, Sweden or Belgium.

Retail

Retail is a sector where we observe a polarisation of pricing between prime and non-prime assets due to the rising threat of e-commerce. In the markets with higher penetration of online sales, such as the UK and France, even prime shopping centre yields have started to soften and they are currently at 5.25% and 5% respectively.

We believe that the most defensive types of retail assets are retail warehouses/parks in dominant locations, which work in complementary ways with e-commerce and omnichannel strategies. Big box retail can be seen as a Core+ investment choice, which may command yields from 5.5% up to 7% in markets such as the UK and Spain, where the concept is well established.

Industrial / Logistics

The only prime commercial assets offering yields above 5% are prime logistics warehouses in certain European markets such as Denmark, Czech Republic, Spain Italy, Portugal, Romania, Poland and Belgium. Even in this market segment, the fast yield compression observed over the past few quarters has pushed income returns below 5% in the UK, the Netherlands, Germany, France, Sweden and Norway. Yield compression has been driven by strong fundamentals, as demand for logistics space is rising across Europe, alongside the growth of online sales. Supply does not keep up with demand in several markets ensuring stable or rising rents. Core+/Value add opportunities in the logistics sector can achieve yields up to 7%. Examples include warehouses around secondary cities in Czech Republic, Spain, Romania, France and Poland.

Student housing

There is an increasing demand for purpose built student housing accommodation across the major European university hubs. In the capitals with large numbers of students, where the concept has been expanding faster, such as London, Paris and Berlin prime yields are already below 5%. However, we believe that there are still Core+/Value add opportunities attractively priced in smaller markets such as Portugal, Poland and Belgium and regional cities in the Netherlands and France.

> “Searching for assets with strong fundamentals but higher returns has become more challenging, but we believe that Europe still offers attractive investment opportunities”

Q1 2019 16% DOWN

According to our first estimates for Q1 2019, the total investment activity across 14 countries will be slightly below €45m, which is 16% down yoy and 41% down qoq. This drop does not come as a surprise for a number of reasons:

UK COMES SECOND

On the one hand the UK, which is normally the largest market in Europe, is expected to rank second after Germany this quarter, with just over €10bn turnover and a 25% drop, mostly due to the ongoing uncertainty caused by Brexit. This affects significantly the total as it accounts for a quarter of the European activity.

GERMANY FIRST BUT LOWER

On the other hand volumes in Germany have also been affected negatively by a lack of prime product as well as concerns about the sustainability of economic growth. German investment turnover is expected to be c. €12bn, 13% down yoy and will account for about 28% of the activity.

FRANCE STABLE

We expect activity in France and the Netherlands to be in line with last year’s levels, while Sweden and Norway may see a rise of up to 56% and 30% yoy respectively. Volumes are estimated to be three to four times higher yoy in Czech Republic and Romania, while they could half in Poland.

WHY REAL ESTATE IS ATTRACTIVE FOR INVESTORS

In what is expected to remain a low interest rate environment going forward, yield spreads will remain attractive for investors investing in prime real estate. Oxford Economics' forecast data show the average 10 year government bond yield for Eurozone constituents has been adjusted downwards over the past 12 months. In January 2018, the 10 year government bond forecast for Q1 2019 was 1.6% pa, whereas in January 2019, it stood at 1.2% pa. Falling expectations of an interest rate rise will continue to attract capital into European real estate as borrowers are able to access debt cheaply. The European composite prime CBD office yield hardened by 11 basis points (bps) to 3.7% between January 2018 and January 2019, providing an attractive yield spread of 250 bps over the cost of long term debt.

250bps

The yield spread of the average prime CBD office yield vs 10-year bond yield in Eruope

> "In what is expected to remain a low interest rate environment going forward, prime yield spreads will remain attractive for investors"

5% plus investment opportunities in Europe: attractive returns in sectors with good fundamentals

Country	Sector and location	Asset type	Yield range
Belgium	Offices in secondary cities, Logistics, Senior housing and Student housing	Core+/Value add	5.0%-7.0%
Czech Republic	Industrial in strong regional manufacturing hubs	Core+/Value add	5.0%-7.0%
Denmark	Multi-tenant offices in Greater Copenhagen	Core+/Value add	5.0%-6.0%
France	Office developments and refurbishments in NE Paris, Inner suburbs and W Crescent	Core+/Value add	5.5%-6.75%
France	Regional industrial in S France	Core	5.25%-5.75%
France	Student residence portfolios in regional cities	Core+	5.0%
Germany	Offices in secondary cities (ex Top-7)	Core+/Value add	5.0%-6.0%
Germany	Light Industrial / Production nationwide	Core+	5.0%+
Germany	Business Parks nationwide	Core+	5.8%+
Italy	Suburban secondary offices in Milan	Core+/Value add	5.25%
Netherlands	Residential nationwide (ex Amsterdam)	Core+/Value add	5.0%-6.5%
Netherlands	Offices in secondary cities	Core+/Value add	6.0%-7.0%
Norway	Offices in fringe locations of Oslo	Core+	5.0%-5.5%
Poland	Secondary offices in prime locations in Warsaw	Core+	6.5%-8.0%
Poland	Industrial and logistics with development potential nationwide	Core+/Value add	6.5%-7.0%
Poland	Older offices with redevelopment/change of use potential nationwide	Opportunistic	10.0%+
Portugal	Logistics in Lisbon region	Core+/Value add	6.5 % -7.5%
Portugal	Offices in Fringe locations of Lisbon	Value add	6.0%-6.5%
Portugal	Hotels in Lisbon, Porto, Algarve	Core+/Value add	6.0% - 7.0%
Portugal	Student Housing in Lisbon, Porto	Core+/Value add	
Romania	Prime logistics in regional cities	Core+	up to 8.5%
Spain	Logistics in secondary locations of Madrid and Barcelona and secondary cities	Core+/Value add	up to 7.0%
Spain	Offices in peripheral locations of Madrid and Barcelona	Core+/Value add	
Spain	Semiprime, convenience retail parks nationwide	Value add	6.0-8.0%
Sweden	Suburban secondary offices in Stockholm, Gothenburg and Malmö	Value add	5.5%-6.5%
UK	Prime retail warehousing in dominant locations	Core+	6.25%
UK	Prime regional city office refurbishment in major regional cities	Value add	6.25%-6.5%

Source: Savills Research

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