

Market in Minutes

Q1 European commercial investment: in search of the right product

May 2016

Economy

■ Europe is now entering its fourth year of recovery and the EU experienced strong GDP growth throughout the first quarter thanks to loose monetary policies, improving labour markets and low oil prices. GDP across the EU is expected to grow by 1.9% in 2016, however political factors such as the British referendum, the repercussions of the refugee crisis and other local political uncertainties could make the road to recovery bumpy.

Lack of sentiment or lack of product?

■ The stagnating European economy, the unpredictable outcome of geopolitical tensions in Europe, the volatility of the stock markets and investor reservations around the valuation of major tech companies, could be adequate reasons to affect negatively investor sentiment and delay decision making and money spending.

■ The numbers indicate that this might be the case as the total commercial investment volume in Q1 2016 was

overall about 30% less than the same period last year at about €36.8bn in EU 15. Nevertheless our local experts report that demand for real estate remains strong amongst investors, the pricing level of the closed deals is still keen and the main burden to high turnover is the lack of good quality assets on offer.

■ Overall half of the markets we monitor recorded contracting transaction volumes in Q1, while activity in the remaining continued to increase. On the one hand lower volumes were recorded in the markets that are ahead in the investment cycle such as UK (-48%), France (-47%) and Germany (-12%) and markets that had a dynamic start last year, which could not be matched in 2016 such as Denmark (-62%), Norway (-47%), Spain (-24%) and Ireland (-33%).

■ On the other hand Italy (54% - including corporate transactions), Austria (14%), the Benelux (12%), Sweden (33%) and Finland (479% - due to some sizeable portfolio and retail transactions and excluding residential) continue to enjoy growing

investment activity, reflecting investor appetite for quality assets in markets with good fundamentals.

■ Crowd funding, angel investors and venture capital will continue to flow in the hubs of research and innovation where new start ups and new ideas are being born boosting further technological development.

Cross border investors in search for the right product

■ The share of cross border investment, after climbing up at historic highs last year has started normalising again from 51% in Q4 15 to 46% in Q1 16. The most significant corrections were noted in some of the most tight markets in terms of availability of product such as France (-21pps), Germany (-17pps), Ireland (-15pps) and Austria (-13pps), while in the UK the share remained stable at 50%. Significant increases were noted in Sweden and Spain (over 30 pps).

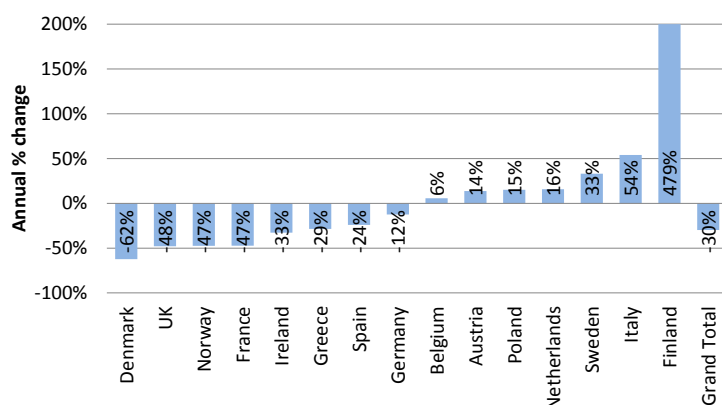
Logistics and distribution attract more capital

■ Overall the office and retail sector have lost momentum last quarter compared to Q1 15, with the total investment turnover dropping by 26% and 30% respectively, but the industrial sector has gained ground increasing by about 19% yoy. This was driven mainly by transactions in the logistics and distribution sector in UK, Germany, Sweden, Spain and The Netherlands, which account for more than 80% of the total activity. Strong annual increases in the volume of transactions were noted in France (115%) and Sweden (260%).

Even lower yields

■ Continuous yield compression for prime product reflects investor confidence in the strength and the

GRAPH 1
Q1 commercial investment volume strong investor demand but lack of product resulted in lower volumes



Graph source: Savills

→ good prospects of the property sector. In Q1 2016 the average prime CBD yield dropped to the record low of 4.6%, 42bps below the 2007 low. This is also 40bps lower than 12 months ago.

■ Markets that experienced significant surge in investment activity over the past twelve months saw their prime yields compressing fast, such as Barcelona (-100bps), Madrid, Milan, Warsaw (-75bps) and Amsterdam (-70bps). In the rest of the markets prime CBD yields are -10 to -50bps lower than last year.

■ Prime office yields are below 4% in London West End (3.3%), Paris (3.3%), Munich (3.7%), Madrid, Stockholm (3.8%), and Berlin (3.9%). Higher risk premia are still applied in Belgrade (9.5%) and Athens (8.0%), where yields moved in by 25bps yoy.

■ Prime shopping centre yields have also surpassed their past low point and in Q1 2016 the average was 20bps lower compared to 2007 at 4.9%. This was also 28bps lower compared to Q1 15. The largest inward movement was noted in Vienna and Brussels (-100bps), while the rest of the markets moved in by -10bps to -5bps with a few also remaining stable. The most expensive markets were Munich (3.7%) and London, Hamburg and Copenhagen (4.0%).

■ Prime industrial yields registered the strongest yield compression in Q1 16, with the average of our markets moving in by 82 bps to 6.2%. Strong yield compression was noted in the Nordic markets, -100 bps in Stockholm and Helsinki. The most expensive markets are overall the German ones and the London region with prime yields between 5.0% and 5.5%. Various

French submarkets, Brussels, Vienna, Warsaw, Milan, Copenhagen and Athens still report prime yields above 6%.

Outlook

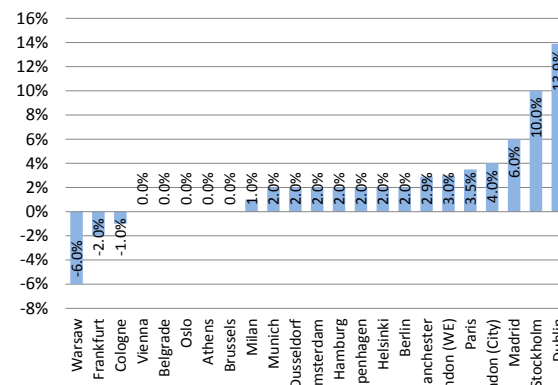
■ The markets that we believe will continue to be high in investors agendas are on the one hand the core markets of UK, Germany and France, which despite lower capital growth prospects and tight supply of assets remain attractive due to their good fundamentals and high liquidity. Strong occupier markets and low development activity is expected to boost rental growth in most markets over 2016. We predict that prime CBD rents will grow by 3-4% pa in London, by 3.5% in Paris and by 2% in four German big cities. From a pricing perspective there is also still some space for further gains in the shopping centre and logistics sectors in France, if we use as a benchmark yield levels achieved in the previous peak of the cycle.

■ On the other hand there are markets that have not reached yet their full potential compared to 2007 high level of investment activity. These include the Nordics, the peripheral markets and the Benelux, which still demonstrate rising transaction volumes. The dynamism of these markets has been reflected in strong prime yield compression, however there is still a gap compared to 2007 levels particularly in the shopping centre and logistics segments offering attractive opportunities to investors.

■ More specifically the recoveries of the economies in Ireland and Spain are fuelling the leasing markets and this year they are expected to be top performers in terms of prime office

GRAPH 2

2016 prime office rental growth projections positive in most markets



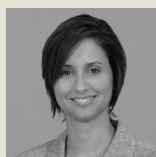
Graph source: Savills

rental growth with 13.9% yoy in Dublin and 6.0% in Madrid. Similarly dynamic is predicted to be the Stockholm market where we forecast prime office rents to increase by 10% this year.

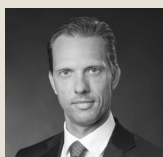
■ We expect volumes to pick up in the course of the year. With low interest rates and a stable economic environment the interest for real estate investments is likely to remain high. In terms of pricing investors will rebalance historically low yields with historically low interest rates and this might need some time to adapt. Rental growth prospects will lead to further impulses to buy further real estate.

■ On the other hand the historically low yields and record prices as well as the economic and political uncertainties will prompt some investors to realise capital gains and off load some real estate which will increase the availability of product. ■

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