

Market in Minutes

Europe remains a buy for overseas investors

July 2015

Economy: Recovery gains strength

■ On the one side markets react nervously while Greece and its creditors have not reached yet a deal that will stop the country defaulting on its debt, but on the other hand Europe's economic recovery is gaining strength, supported by cheap oil, weak euro and more aggressive monetary policy from the ECB.

■ A preliminary estimate shows that GDP picked up momentum in the first quarter increasing 0.4% q-o-q, which marked the fastest pace of growth since Q1 2011. This was also the first time in four years that the Eurozone economy expanded faster than the US and UK economies.

■ For the first time since Q2 2010, all four largest economies registered growth, led by Spain (0.7%), followed by France (0.6%), Italy (0.3%) and Germany (0.3%).

■ Outside the Eurozone, UK economic growth slowed down in the first quarter of the year (0.3%), due to uncertainties surrounding the outcome of the general elections, however following the definitive result prospects for the second quarter have improved.

■ Focus Economics panelists raised their growth forecast from 1.4% to 1.5% for 2015 and to 1.7% for 2016 for the Euro area.

■ Economic sentiment in the Eurozone stabilised in May, remaining at high levels. The resolution of the Greek debt crisis would help to lift uncertainty and boost consumer and business confidence across the Union leading to more investment and growth.

Q2 on track to match or exceed Q1

■ The second quarter of the year is on track to match or even exceed Q1 commercial property investment in Europe. According to RCA there have been about €29.7 bn transacted to date and another €16.3 in the pipeline.

■ The protagonists of the strong flows of capital in European property are cross border investors from outside Europe. US/Canada and Middle Eastern money is securing large-scale investments, involving iconic buildings in the major capitals and/or diverse portfolios in the strongest markets. UK, French, German and Swedish capital also remains highly active.

■ It is no surprise that London region, Paris and the big German cities Berlin, Munich and Frankfurt are still amongst the top destinations of investment despite keen pricing levels. In these liquid and transparent markets investors have the opportunity to move comfortably up the yield curve and to start looking for secondary assets across segments. This may imply either secondary assets in prime locations or prime assets in regional cities.

■ The peripheral markets of Dublin, Madrid and Milan have an established place in the top investment destinations. Investor sentiment towards these markets has firmly shifted supported by positive news on the economies, attractive pricing and supply of product.

■ Amsterdam is also experiencing a significant pick up in international investor interest with rising volumes of transactions and a sizeable pipeline of assets on the market.

OUTLOOK

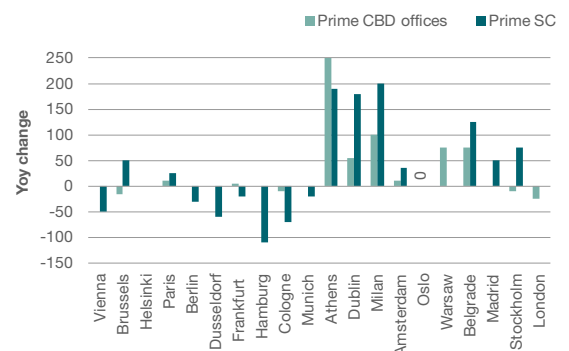
Investors will search for the market segments with the potential for yield compression or rental growth

■ On the assumption that Greece reaches a deal with its creditors, which will avert a major financial crisis in Europe, we believe that investors will increasingly seek opportunities in markets that maintain their positive spread over the past peak and thus better prospects for further yield compression.

■ Prime CBD offices in London (-25), Brussels (-15 bps), Cologne (-10 bps) and Stockholm (-10 bps) have already dropped below their previous yield low. Paris and Amsterdam (10 bps), Dublin (55bps), Warsaw, Belgrade (75 bps), Milan (100 bps) and Athens (250 bps) are still above the last market low.

■ At the same time Shopping centre yields have still way to compress in most markets except in Germany where recent strong investor interest in the sector has pushed down prime shopping centre yields from 20 bps (Munich, Frankfurt) to 110 bps (Hamburg) below the previous market cycle.

GRAPH 1 **Current vs historic low yield prime yields at record low in London and DE**



Graph source: Savills

➔ In the Nordics international investors have to compete with well established domestic players and often are focusing on retail and logistics assets where yield compression has been less aggressive.

New record lows for yields

Prime yields, CBD offices in particular, have hit record lows in many markets, pushed down by the competition for the best assets and the leeway for further yield compression allowed by low bond yields and interest rates. There are only few comparatively attractive priced markets, at least with regards to the prime segment.

Except from London, Paris and Munich where achievable prime yields are below 4%, the majority of the markets achieve yields between 4% and 5% for the best offices in the CBD. Achievable yields at or above 5% may be found only in Warsaw, Athens and Belgrade.

The Shopping Centre segment and even more so the Logistics segment offer overall higher returns and they should benefit from the competitive conditions in offices. Potential sellers can benefit from strong buyer interest.

The average of prime CBD offices for our survey area in Q1 was at 4.9% and in May has shifted in by 7 bps. Dublin, Paris, Frankfurt, Cologne, Amsterdam, London, Madrid and Stockholm pushed down the average as prime yields there compressed significantly.

The average of prime achievable regional shopping centre yields moved in more significantly from 5.34% in Q1 to 5.25% in May. Halfway through the second quarters, prime shopping centre yields have hardened by 15 bps in all German cities and Amsterdam. Warsaw saw a move of -25 bps and Vienna of -50 bps.

Logistics, traditionally the highest yielding segment have also experienced similar trends. The average prime yield was at 6.9% in May compared to 7.1% in Q1. Prime achievable yields moved in by about 10-20 bps in German cities and Amsterdam, by 25 bps in Stockholm and London and by 50 bps in Vienna and Warsaw. The shift of investor interest in less competitive and better rewarding sectors is already felt.

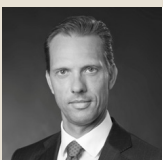
TABLE 1

Prime interim Q2 yields Historic lows are reached in many markets

Interim Q2 2015	Prime CBD yields**	Prime Shopping centre yields	Prime logistics warehousing yields
Vienna (Gross)	4.75%	5.00%	6.50%
Brussels (Gross)	4.50%	5.00%	6.75%
Helsinki	4.50%	4.75%	6.75%
Paris	3.60%	4.25%	6.75%
Berlin	4.20%	4.60%	NA
Dusseldorf	4.20%	4.60%	6.10%
Frankfurt	4.20%	4.60%	6.00%
Hamburg	4.20%	4.60%	6.00%
Cologne	4.40%	4.60%	6.10%
Munich	3.90%	4.60%	6.50%
Athens	8.25%	7.50%	10.00%
Dublin	4.30%	4.80%	7.00%
Milan (Gross)	5.50%	7.00%	8.25%
Amsterdam	4.90%	5.60% (Gross)	6.60% (Gross)
Oslo	4.50%	5.00%	5.00%
Warsaw (Gross)	6.00%	5.50%	7.25%
Belgrade	9.50%	8.75%	12.00%
Madrid	4.00%	5.00%	NA
Stockholm	4.15%	5.00%	6.00%
London	3.00%	4.25%	4.75%

Graph source: Savills, *West End, ** yields are quoted Net unless noted otherwise

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Savills plc

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