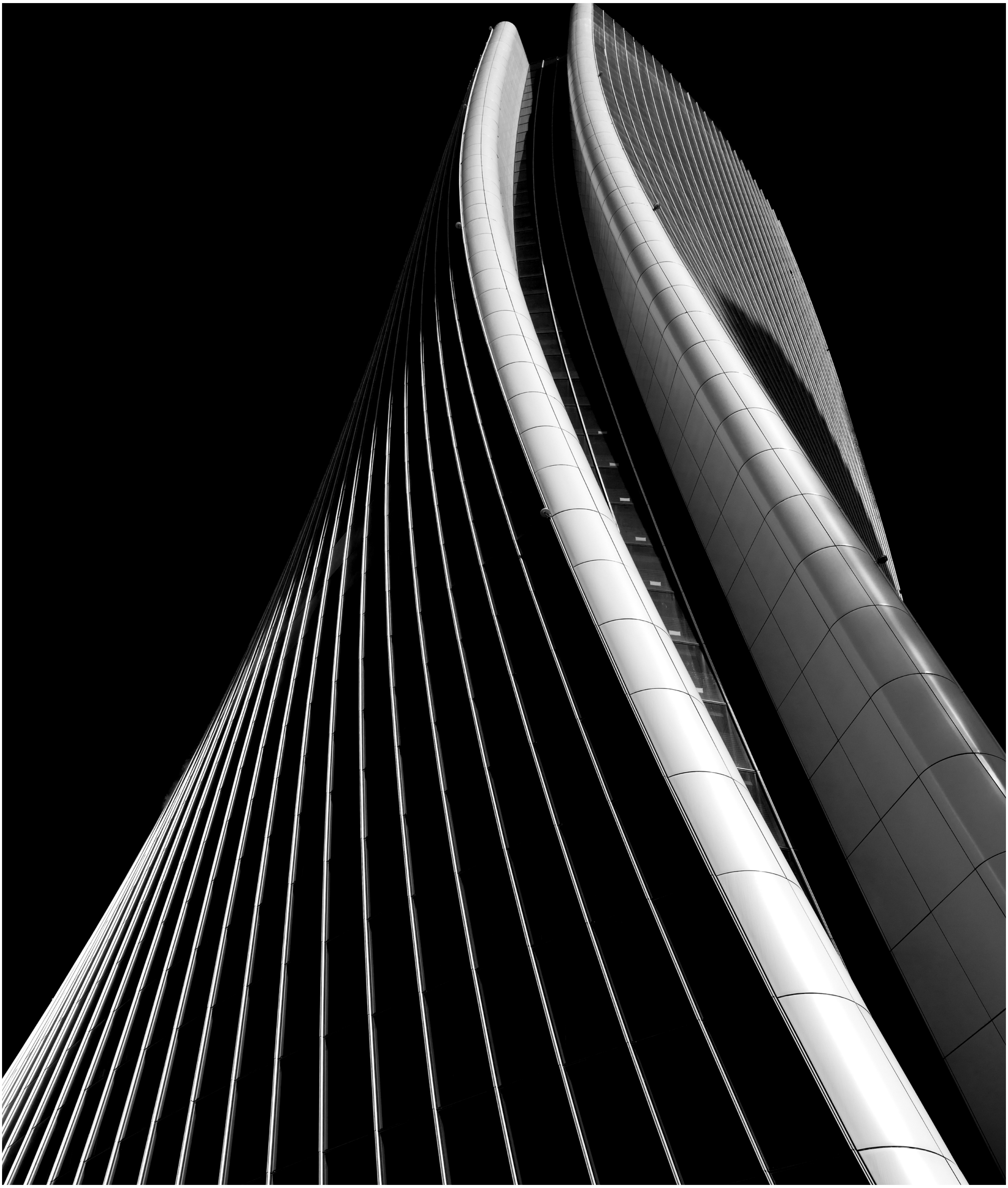
SPOTLIGHT
Savills Research

European Investment

Preliminary Q3 figures



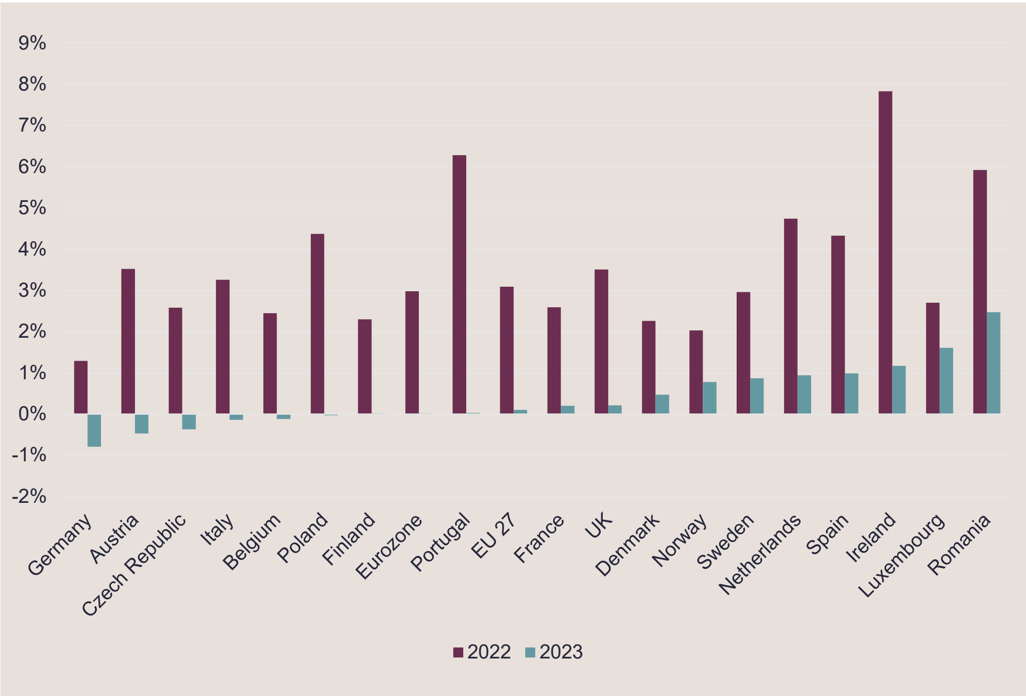
Q3 First estimations ● End-year Outlook

Winter is coming...

The economic outlook is seemingly clouding as we are approaching winter, whilst energy supply is short and costs are skyrocketing. The Euro area annual inflation rose to 9.1% in August 2022, up from 8.9% in July according to Eurostat, with still energy and food accounting for the largest components of this high inflation. Against the backdrop of the indefinite shutdown of Nord Stream 1 in early September, the single biggest pipeline for gas from Russia to Europe, European Union energy ministers are discussing emergency measures in an attempt to level off prices. That said, Economists still agree upon the fact that the peak remains ahead.

The impact of surging prices has now clearly materialized in nearly all aspects of the European economy. In July, the Eurozone industrial production declined by 2.3% monthly, with energy-intensive industries reporting a steeper drop in output. Based on the slippering curve of manufacturing new orders, the industry is expected to further contract in the next six months. In August, the Economic Sentiment Indicator (ESI) in the European Union decreased further by -1.0 point to 96.5. By contrast, the European Union's consumer confidence rose by 1.0 points to -26.0; results likely to be linked to the summer break season. The labour market has held up well, as the eurozone unemployment rate hit a record low in July (6.6.%). However, Capital Economics forecast the unemployment rate to rise to 7.5% by mid-2023. This would add up to the inflationary headwind for consumer spending. Hence, retail sales are expected to decline in the coming months. In July, overall retail sales rose only slightly by, 0.3% M-o-M, whilst sales of non-food products plummeted, suggesting some consumers start holding back on discretionary spending. All in all, the Eurozone is expected to grow by 3.0% in 2022, and be close to zero in 2023, according to Oxford Economics.

European GDP: Strong economic slow down is expected in 2023



Source: Oxford Economics

European Investment - Q3 2022 preliminary figures

...causing an investment lull

Our preliminary results suggest that the total investment volume for the third quarter of the year will be around €55bn, which would bring the total volume cumulated from Q1 to Q3, slightly north of €200bn. This will represent a 10-11% drop compared to the same period last year. Whilst, at the time of writing, it is too soon to provide exact country figures, we can already affirm that the investment lull significantly spread across the continent compared to H1.

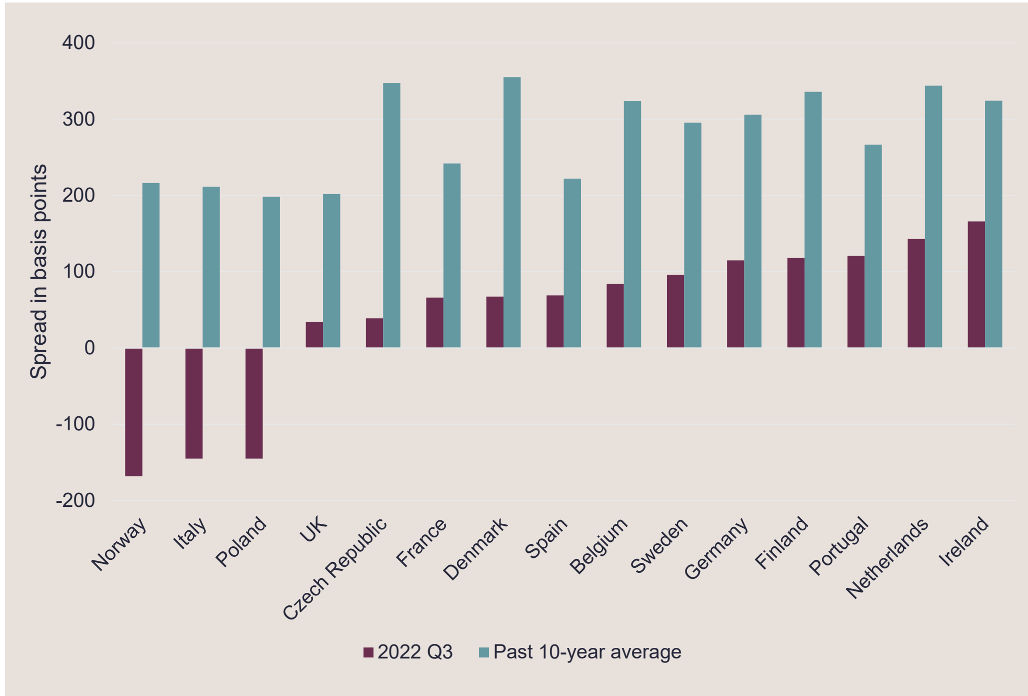
This quick market adjustment is resulting from the combination of three factors. First, To tackle the surge in inflation, central banks have been forced to raise rates to historically high levels. The narrowing gap between bond and real estate yields is increasingly unfavourable to real estate. On average across Europe, the spread between real estate and long-term bond yields dropped to 44 bps in September from 279 bps on average in the past 10 years. Second, the rising cost of debt is reducing the range of opportunities in terms of countries, locations and in terms of asset classes, with the very low-yielding assets looking increasing unviable. It is also reducing the range of active market players. We are seeing a growing activity from cash-rich investors, such as sovereign wealth funds, whilst private equity investors are slowly retrenching. Third, the strong inflation is starting to drag down the European economy, which in turn affect investors sentiment. Historically, GDP growth and real estate investment volume have been strongly correlated.

Annual change in investment volume	Q1 22	Q2 22	Q3 22	Q4 22
UK	47%	-26%		
Germany	54%	-41%		
France	3%	48%		
Spain	-29%	10%		
Ireland	-38%	56%		
Italy	135%	34%		
Portugal	-20%	39%		
Netherlands	48%	10%		
Sweden	10%	-26%		
Belgium	84%	72%		
Norway	-1%	-36%		
Finland	158%	31%		
Denmark	40%	76%		
Poland	20%	4%		
Czech Republic	210%	-41%		
Romania	53%	42%		
Hungary	17%	-26%		

Negative YoY growth

Source: Savills

10y bond vs prime office CBD yields: the spread decreased by 235bps compared to the long term average



Source: Savills , Focus Economics, OECD

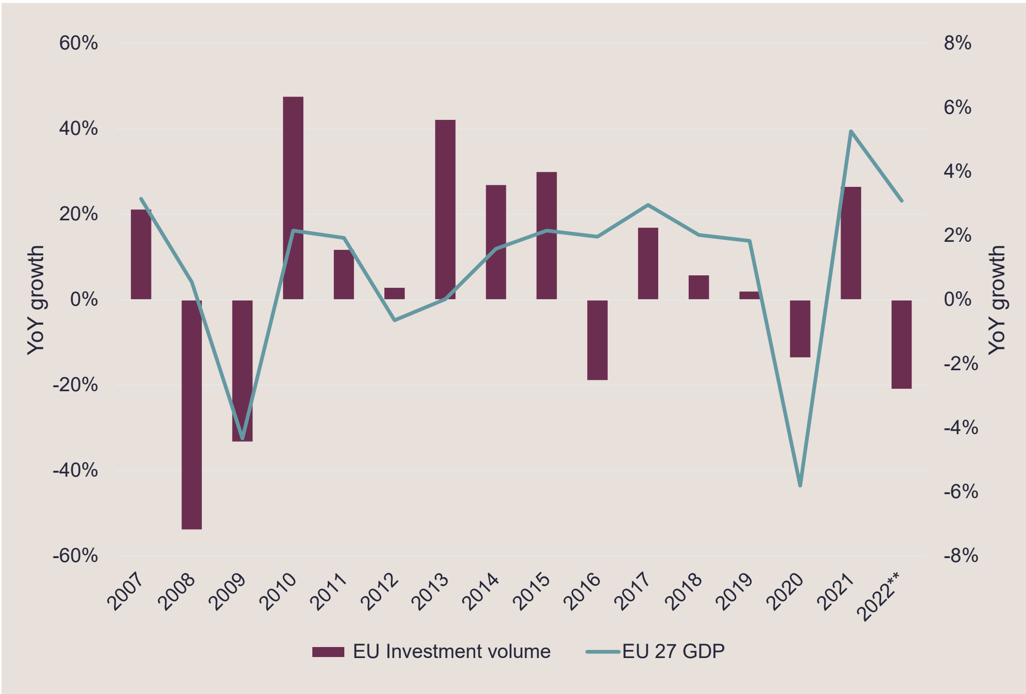
Positive notes & end-year Outlook

In spite of the strong headwinds undermining investment activity, the European investment market is in better position than in the last cycle for two reasons. First, prices started to adjust quickly (+13bps qoq across Europe in Q2, +30pbs qoq in the German cities). This is good news because the bid-ask spread is the main stumbling block threatening to bring the market to a standstill. Second, although the economic slowdown will deteriorate the level of occupier demand in most sectors, vacancy rates are generally low and an increase in new developments is unlikely given the fast-rising construction costs.

We anticipate the end-year volume to range between €275bn and €280bn. Sheds and Beds will remain the preferred asset classes. In both sectors, a structural supply and demand imbalance is favouring rental growth. And going forward; property fundamentals will become again the key drivers of all investment decisions. We have recorded strong investment activity in student housing during the first part of the year and we expect it will continue. And this is unsurprising given the countercyclical nature of the sector. During economic slowdowns, which ultimately affect the labour market, the number of students rises, hence, the demand for student accommodation is growing. At the other end of the spectrum, we expect the overall retail and leisure investment volumes to be negatively impacted by slowing down consumer spending

Historically in uncertain times, investors tend to reposition their activity domestically, because their national market is easier to read and access. This trend has not materialized in H1 cross-border investment figures but we expect the share of domestic investment to start rising in Q3 across Europe. That said, international cities such as London, Frankfurt, Berlin or Paris will remain magnet destinations for cross-border investment. Beyond Europe's borders, the weakening euro and the European real estate position in the global property cycle may catch some investor's attention. All in all, for the next six months, we expected the overall cross-border investment activity will be reduced to established gateways and mostly fuelled by non-continental capital.

Investment volume vs GDP: strong correlation between GDP growth and investment activvity



Source: Savills, Oxford Economics

European Investment - Q3 2022 preliminary figures

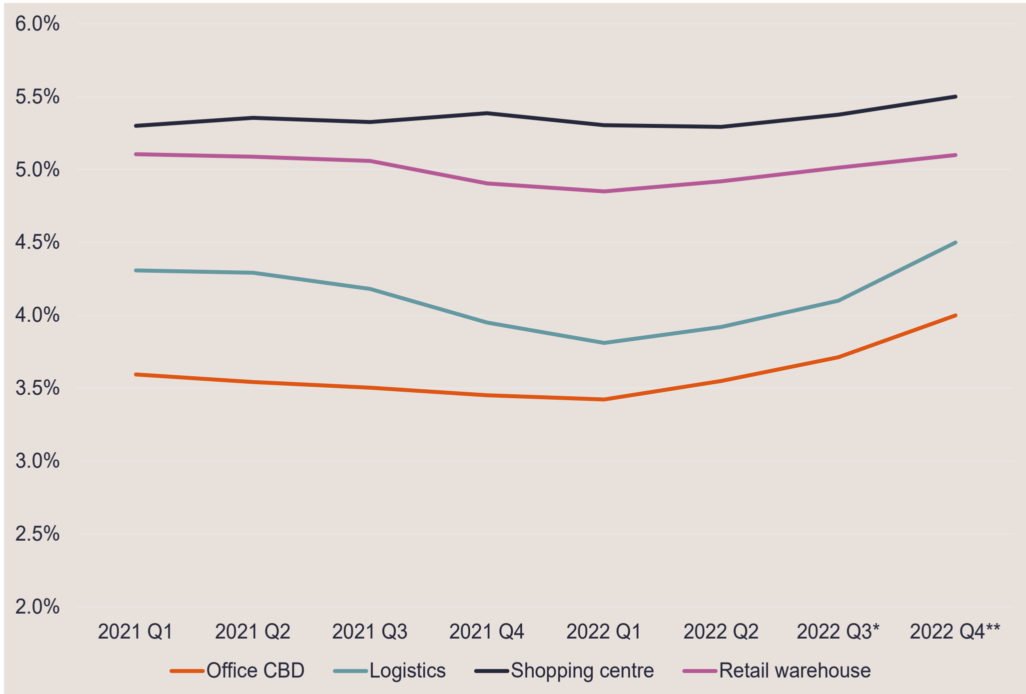
Yield decompression continues apace in H2 2022

Preliminary figures suggest that prime office CBD yields moved out by another 16 bps this quarter at around 3.71% on average across Europe. Due to the shift in the investment landscape towards more opportunities and less competition, we estimate that by the end of 2022, the average prime office CBD yields will have risen by approximately 55 bps since the start of the year.

Our preliminary Q3 2022 data indicate that prime logistics yields moved out by 10 bps qoq at around 4.10% on average across Europe. The fundamentals of the logistics market will lose momentum, with the declining purchasing power affecting sales - including online sales - and ultimately distribution. However, this is likely to be counterbalanced, at least partially, by increasing demand from manufacturing companies resulting from the growing nearshoring business strategies. By the end of 2022, we anticipate the average prime logistics yields will have risen by 70 bps since the start of the year.

The retail sector is about to face another storm, with the European purchasing power about to decline. Hence, prime shopping centres' yield decompression is continuing. Our first Q2 results show that prime shopping centre yields moved out by another 8 bps qoq to 5.38%. By the end of the year, we expect the average prime SC yields will move out by 11 bps yoy. On the other hand, prime retail warehouse yields moved out by 9 bps qoq, according to our first Q3 estimations and we anticipate that it will move out by 19 bps annually in the final quarter of the year.

Prime yields: By year-end, prime yields are expected to soften by 55 bps yoy for offices, 70 bps for logistics, 11 bps for SC and by 19 bps for RW



Source: Savills / *Preliminary figures ** Foracast

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